DOD STUDY OF THE MILITARY EXCHANGE SYSTEM

Volume I * Study Report
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Table of Contents

Chapters

Comments To The Study

PREFACE

The Department of Defense study of the Armed Services Exchange System was initiated 27 April 1990 by the Assistant Secretary of Defense (Force Management and Personnel), Mr. Christopher Jehn, in response to a Congressional request that DoD undertake a feasibility review of military exchange consolidation. The tasking to the study group was to conduct an unconstrained baseline assessment of the Department of Defense Armed Forces exchange systems to identify increased efficiencies, reduce overhead costs and increase savings in nonappropriated fund and appropriated fund resources. The study was to review all functional areas of the exchange systems and identify efficiencies, including the feasibility of consolidating some or all functional areas. Any recommended changes were to be based on maintaining the same or higher level of service to the customer with no increase in cost. This study is submitted to fulfill the study group tasking.

The study organization included a review group, a steering group, an advisory group and the study group. The review group consisted of selected membership at the Assistant Secretary of Defense, Comptroller of Department of Defense, Deputy Assistant Secretary of Defense, Service Deputy Assistant Secretary and Joint Chief of Staff level. This group, chaired by Mr. Jehn, insured conformance with Deputy Secretary of Defense guidance, the Department's long range goals, Service requirements and Congressional direction. The steering group was represented by the Services' Deputy Chief of Staff for Personnel/Manpower, the Coast Guard Office of Personnel/Training and the Deputy Assistant Secretary of Defense Comptroller. This group, chaired by Lieutenant General Donald W. Jones, Deputy Assistant Secretary of Defense (Military Manpower and Personnel Policy), provided advice to the Chairman on the study direction and subsequent

recommendations to ensure they supported service requirements as well as the viability of the resale system. The advisory group consisted of the commanders of the Service Resale Activities, the Director, Marine Corps Morale, Welfare and Recreation Support Activity and the Chief of Coast Guard Exchange and Morale Office. This group provided technical advice to the steering group chairman and steering group members. The study group consisted of a staff director, a deputy staff director and nine major functional area chairmen, with membership of this group representative of the Services. This organizational structure brought together qualified individuals to conduct the study and provided for the necessary oversight guidance and assistance by Department of Defense (DOD) and the Military Departments.

The study group sought and received input from industry trade groups and experts, the military exchange systems' staffs, military installation commanders, senior noncommissioned officers, exchange patrons and regional and local exchange personnel. Extensive onsite visits were conducted to various CONUS and overseas resale activities, ships stores afloat, distribution facilities, Navy lodges and vendor support operations. The review took place between May and August 1990.

B. Industry and Trade

Appendices

PARTICIPANTS

REVIEW GROUP

Assistant Secretary of Defense for Force Management and Personnel, Honorable Christopher Jehn

Assistant Secretary of Defense for Production and Logistics, Honorable Colin McMillan

Comptroller, Department of Defense Honorable Sean O'Keefe

Director of Manpower and Personnel for the Joint Chief of Staff, Brigadier General Mike Vergamini, USAF

Deputy Assistant Secretary of the Army for Military Personnel Management and Equal Opportunity, Mr. Robert Emmerichs

Principal Deputy Assistant Secretary of the Air Force for Manpower, Reserve Affairs, Installations and Environment, Ms. Judy Ann Miller

Deputy Assistant Secretary of the Navy for Manpower, Mr. Robert Silberman

STEERING GROUP

Chairman and Deputy Assistant Secretary of Defense (Military Manpower & Personnel Policy), Lieutenant General Donald W. Jones, USA

Deputy Chief of Naval Operations for Personnel, Vice Admiral J. M. Boorda, USN

Air Force Deputy Chief of Staff for Personnel, Lieutenant General T. J. Hickey, USAF

Army Deputy Chief of Staff for Personnel, Lieutenant General William H. Reno, USA

Marine Corps Deputy Chief of Staff for Manpower and Reserve Affairs, Lieutenant General Norman Smith, USMC

Chief, Office of Personnel and Training,
Rear Admiral George D. Passmore, USCG

ADVISORY GROUP

Commander of the Army and Air Force Exchange System,
Major General Jeffery D. Kahla, USAF

Commander of the Naval Resale and Services Support Office, Rear Admiral Harvey D. Weatherson, USN

Director of the Marine Corps Morale, Welfare and Recreation Support Activity, Brigadier General James Joy, USMC (Ret)

Chief of Coast Guard Exchange and Morale Office,
Captain Donald A. Anderson, USCG

STUDY GROUP

Colonel Thomas E. Loughlin, USMC, Director

Colonel Alfred J. Finch, USA, Deputy Director

Commander Roger J. Blood, USN, Distribution/Transportation Systems

Mr. Charles E. Wiesneth, AAFES, Distribution/Transportation Systems

Mr. Samuel L. Lankford, AAFES, Management Systems

Lieutenant Commander Bruce G. LaLonde, USN, Operations Management

Mr. William J. Barnes, AAFES, Finance/Business Strategy

Ms. Pam Crespi, NMPC, Finance/Business Strategy

Lieutenant Colonel William F. Bowlin, USAF, Finance/Business Strategy

Mr. Scott H. Ash, USMC, Personnel

Mr. W. Michael Moreland, AAFES, Inventory Management Systems

Mr. William N. Baucum, AAFES, Facilities/Construction Systems

Mr. J. Van Heiningen, Deputy Exchange Manager, Service Operations, NRA Memphis

Mr. George Vomvoris, AAFES, Food Operations

ADMINISTRATIVE SUPERVISOR

SSG Lloyd O. Rodgers, USA

ADMINISTRATIVE SUPPORT

Ms. Eleanor Jones, USN

A1C Jennifer L. Cox, USAF

LCPL Deanna M. Leger, USMC

CHAPTER 1

EXECUTIVE SUMMARY

BASIS FOR SUBMISSION

This report on the Armed Services Exchange System is submitted in response to Mr. Atwood's (Deputy Secretary of Defense) direction that a review of the military exchanges be conducted. This directive led to the formation of an exchange study group with representatives from each of the Armed Services, the Army and Air Force Exchange Service (AAFES), and the U. S. Coast Guard. Due to the limited time available to conduct the study, and the need for individuals sufficiently experienced and knowledgeable in exchange operations, the Services selected personnel from their exchange systems with extensive resale experience.

The study group prepared this macro, conceptional report with input from review and steering groups comprised of senior military and civilian leaders, a technical advisory group of exchange system commanders, functional experts from the exchange systems' staffs, installation commanders, the senior noncommissioned officers of the military services and exchange patrons. All cost and savings projections for the alternatives considered are based on estimates developed by the study group staff. All estimates are, however, considered conservative.

The report is organized into the following chapters:

- **Chapter 1** summarizes the study report, gives the basis for submission and outlines the study group's overall assumptions, methodology, findings, conclusions, and final recommendations.

- **Chapter 2** gives a history and evolution of the exchange systems, presents the current scope of operations and provides a description of each of the separate exchange systems.

- **Chapter 3** analyzes current

financial, business and organizational strategies of the exchange systems, explains current MWR distribution policies, and details estimated savings and one time implementation costs.

o **Chapter 4** examines exchange procurement and inventory management functions and potential benefits through centralization.

o **Chapter 5** reviews the existing distribution and transportation systems of the exchange systems and proposes organizational changes to increase efficiency.

o **Chapter 6** examines current and projected management information systems utilized by the exchanges.

o **Chapter 7** focuses on customer service, store and installation operating procedures and special exchange programs.

o **Chapter 8** discusses the various food programs of each service, including the potential for increased service and earnings.

o **Chapter 9** discusses the broad category of services operations and how each exchange system fulfills these requirements.

o **Chapter 10** outlines options for operating design construction departments of the exchange systems more cost effectively.

o **Chapter 11** discusses human resources program similarities and differences of each system and potential efficiencies through cooperative actions.

o **Chapter 12** examines the employee benefits programs of each system and the costs and impact of any proposed change.

o **Finally,** there are several appendices which provide additional data and a more detailed analysis of specific topics.

STUDY OBJECTIVE

The study mission was to provide an unconstrained baseline assessment of the Department of Defense Armed Forces exchange system with the objective of identifying increased efficiencies, reducing overhead costs and increasing savings in nonappropriated fund and appropriated fund revenues. Any recommended changes were to maintain the same or higher level of service to the customer with no increase in cost. All functional areas of the exchange systems were subject to review for efficiencies, with the review to include, but not be limited to, the feasibility of consolidating some or all functional areas.

THE EXCHANGE MISSION

Each of the exchange systems has a similar dual mission of providing patrons with merchandise and services necessary for their health, comfort and convenience,

and of serving as a supplemental source of funding for military Morale, Welfare and Recreation (MWR) programs. The exchange located on military installations encompass a wide variety of resale activities, and compare favorably with commercial retail stores and shopping malls. Included in the list of exchange activities are retail, food and automotive outlets; personal services such as barber shops, beauty shops and laundry/dry cleaning; amusement and vending centers; Navy Lodges; and, in the case of AAFES, motion picture theaters. The exchanges serve as an important nonpay military benefit, providing vital services worldwide and saving the patron an average of 20% over outside prices.

The exchange systems are unique Government organizations in that they operate almost entirely on revenues generated from the sale of goods and services. These sales dollars pay for civilian employee salaries, merchandise inventory investment, most distribution and utility costs and capital expenditures for equipment, vehicles and facilities --- in short, all the normal costs of doing business. Limited appropriated fund (tax dollar) support is received for paying some overseas transportation costs; utilities overseas and in designated isolated and remote areas; and common services such as fire and police protection.

Exchanges are an integral part of the military Services quality of life programs, providing on-base services as well as generating earnings to support MWR programs such as libraries, child care and youth centers, fitness programs and other vital quality of life programs.

FINDINGS

The review group soon determined that the current exchange systems are financially sound, serving their patrons well and making valuable contributions to the MWR program. However, with three separate exchange systems accomplishing the same basic mission, often within the same geographical area, there are duplications and redundancies in both overhead and operating costs. This is in no way meant to imply that any one of the systems is not pursuing actions to optimize their separate operation.

Yet, these are tumultuous times and any immediate, system-wide consolidation taken simply to realize the anticipated savings identified in this study would involve significant risks and could adversely affect customer service, ongoing programs and exchange earnings, and ultimately support to MWR.

The exchange systems today are operating in a rapidly changing political environment and are absorbed in the process of adjusting to a variety of internal and external influences beyond their control. These factors are impacting on traditional methods of operation, and any attempt to project future savings on recent historical data must take them

into account. In an unbelievably short span of time we've seen the Berlin Wall come down, action initiated and almost concluded for the reunification of Germany, political reforms instituted in the Soviet Union, the loosening of the Soviet grip on her member states, and an overall reduction in tensions between East and West. This has led to calls for massive cuts in defense spending which will be reflected in major force reductions and base closures. In a 19 June 1990 news briefing, Secretary of Defense Cheney responded to a Congressional inquiry regarding the impact of a 25% force reduction --- equal to approximately 442,000 military personnel. The most recent crisis in the Middle East may also influence future force structure and basing decisions.

The exchanges are also facing increased competition from outside retailers, which is expected to grow through niche formats, everyday low prices, warehouse/superstores and the movement of major competitors into sections of the country they did not previously operate. To remain competitive, the exchanges must stay abreast of and implement current retailing concepts such as electronic data interchange and rapid replenishment by suppliers.

Each of the separate exchange systems has responded to this changing environment by instituting actions to scale down and consolidate overhead operations and reduce costs to meet the challenge of significant reductions in the patron base. Within AAFES, project "Fresh Start" is well underway. This project will reduce and relocate the four major CONUS geographical headquarters elements to Dallas. Additionally, actions have been initiated in both Europe and the Pacific to reduce staffing to meet reduced support requirements due to changes in force levels. AAFES' automated management information and communication systems are being greatly expanded with a satellite communication network and installation level computers to support operations and decision-making functions.

The Navy Resale System has begun steps to reduce costs by reducing the number of Field Support Offices (FSOs) and further centralizing some distribution and procurement functions. Additionally, the Navy Resale System is faced with the complicated process of divesting commissary operations and the associated organizational turmoil. The Navy also has a program to update and improve their management information system.

In the Marine Corps, the exchange and MWR activities were merged into a single organization barely a year ago. Any exchange consolidation would require this organization to be split at a time when it is both recovering from this action and is placing total concentration and effort on managing the eminent changes due to force structure adjustments.

Although the U. S. Coast Guard participated in this study, primarily in an observer status,

no consideration was given nor analysis performed on including them in any consolidation of the Armed Services exchange systems.

ANALYSIS OF ALTERNATIVES

The study group considered and evaluated a number of alternatives, including continuation of separate systems (status quo), a variety of partial consolidation scenarios such as centralized support to separate systems and geographical responsibility by dominant system, operation as a Government sponsored enterprise (GSE), and total consolidation. Since the partial consolidation scenarios were cumbersome, did not provide major savings and were not supported by the military Services, they are not presented here. These alternatives are, however, discussed in later chapters and could become a step in the movement to total consolidation if that course of action is selected. There appears to be no advantage in converting from a nonappropriated fund instrumentality to a GSE.

The major pros and cons of the two remaining alternatives, status quo and total consolidation, as identified by the study group, are summarized in Figure 1-1 at the end of this chapter.

CONCLUSIONS

Despite the complexity of this action, total consolidation of the three military exchanges is feasible and is the most cost effective alternative. There currently is, in fact, a consolidated exchange system in existence. AAFES serves both the Army and Air Force worldwide. While the study group can identify savings through further exchange consolidation, such action must be taken carefully over time due to force structure uncertainties, with check points built in for review action before moving from phase to phase.

Figure 1-2 presents a summary of projected savings and costs which could be realized through a total consolidation of the exchange systems. Net savings are expected to be $44.2 million annually. (The full impact of these savings would not be realized until the end of the implementation period.) One-time net implementation costs, projected to be $10.8 million, and the impact on personnel are also summarized in Figure 1-3. Chapter 3 gives a more detailed analysis and explanation of the savings and cost figures.

It should be noted that the personnel impact of consolidation would be substantial and every effort should be made to reduce the affect on individuals, such as offering early retirement, placement services, etc.

Since AAFES is the largest system (73% of total direct sales; 74% of employees) and has in place a worldwide, sophisticated infrastructure, it is only logical that any consolidation would be

built around this infrastructure.

The basic methodology used as a starting point for determining costs and savings in each of the functional areas was as follows (using AAFES as the core organization):

- Identified common functions and eliminated the positions currently performing those functions at Navy and Marine Corps Headquarters, Regional and Local Levels.

- Based on a selected productivity measure, determined cost of adding additional people to the core organization (Total people required less those on hand at core organization).

- Net savings is the difference between total savings and added cost.

- Compute one-time implementation costs.

- Once this was determined, it was refined by comparing more closely the actual functions being performed by the personnel in each exchange system.

Conclusions relating to each of the major functional areas follow:

o Financial/Business Strategy. Because of differences in accounting procedures, financial reporting, operating environments and other factors, comparison of financial indicators for the exchange systems is not an accurate measure of performance. However, all three systems are financially healthy, with profitability figures that generally exceed commercial industry averages. Each system provides patrons a savings of at least 20 percent overall, while continuing to generate funds to support MWR. A pro forma analysis (see chapter 3) indicates an increase in total earnings could be achieved if the exchange systems were consolidated. The accounting functions were specifically reviewed. Approximately $5.4 million could be realized from increased efficiencies gained by consolidating and centralizing the accounting functions.

o Purchasing/Inventory Management. Efficiencies can be realized by consolidating the exchange services' buying and contracting functions. Consolidation of these functions into the existing AAFES infrastructure will eliminate the duplication that now exists. The AAFES system is capable of supporting the combined sales of the consolidated exchange system. It would require an incremental increase over current staffing levels of about 337 positions with wages, including fringe benefits, of about $9.8 million. Computed savings, within the purchasing area only, are projected to be 824 positions with salary of about $22 million.

o Distribution and Transportation. Increased efficiencies would result from a consolidation of AAFES and NAVRESSO distribution centers in

CONUS. The consolidated distribution system would have the capability of supporting the three current exchange systems. Consolidation of the Norton AFB (AAFES) replacement facility (with a project scope of $9.6 million, to be partially offset with base closure funds) and the NAVRESSO FSO San Diego distribution center at a cost effective location, or expansion of the San Diego facility, could not be accomplished before FY 93. Consolidation of exchange system management will also result in reduced overhead requirements at several overseas locations. Total annual savings from consolidation are estimated to be $9.7 million.

o Management Information Systems. Consolidation of the three exchange systems into a single entity will require a worldwide communications and data processing capability. AAFES is the only exchange system with the existing MIS infrastructure and can support the many and varied businesses included in the exchange systems. Each part of the AAFES MIS infrastructure has been specifically designed to operate in every country with military presence. All MIS components conform to the applicable local laws, Status of Forces Agreements, U. S. military regulations and national/ international communications protocols/equipment technical specifications. One-time costs of the MIS consolidation into the AAFES infrastructure is projected at $37.9 million, which would be offset by a MIS cost avoidance of $60.1 million, resulting in a net savings of $22.2 million over the projected costs of the three separate MIS support systems.

o Operations Management. Even with differing retail store manning objectives and levels of management commitment, each exchange system is providing satisfactory customer service. To standardize store staffing levels under a total consolidation scenario, additional personnel costs of $13.3 million per year will be required. Other issues addressed include removal of current restrictions placed on mailing of promotional literature, and merchandise authorized for sale. Also, the sale of nonessential items in the commissaries must be addressed due to the impact of these sales on the exchanges' ability to generate funds for MWR.

o Food Operations. Total sales, profits and customer service would be enhanced by consolidation into a single system. Such an action would result in a one-time cost avoidance of $1.8 million for development of separate in-house food concepts. The proven AAFES food programs, modern information and management systems and worldwide organizational infrastructure dictate this system should be used as the core for a consolidated organization.

o Services Operations. Services operations, such as barber and beauty shops, laundry and dry cleaning, tailor shops, automotive services, flower shops, electronic repair, tax

preparation, optical, photo and film developing shops, etc., would generally continue to operate under consolidation as they do now. Although broad policies and procedures govern their operation, these activities are established and organized to meet local requirements and may be either direct (exchange operated) or concession (contractor operated) based on the situation. Annual savings of $0.3 million are possible through consolidation and reduction of headquarters staffs.

o Design and Construction. Centralized design and construction would be cost effective and increase efficiencies whether the exchange systems are consolidated or not. The AAFES organization has this capability. Projected savings are $.92 million per year under total consolidation.

o Personnel. A number of individual and collective improvements were identified in human resources programs. If consolidation occurs, they could result in new personnel programs which may be better able to attract, retain, compensate and reward employees.

o Employee Benefits. Due to the number of variables present in the three systems and uncertainty over the design of successor plans for welfare benefits and retirement, a reasonable projection of costs/savings could not be estimated at this time.

During the course of this study, there were inferences by some Navy, Marine Corps and AAFES individuals that in the event of consolidation, AAFES initiatives would remain in place while initiatives of the other exchange systems would be lost. These perceptions are wrong. Each system has good ideas and, in the event of consolidation, the new organization would be expected to evaluate these ongoing initiatives and take the best from each system.

It should be noted that this is not the first study of the military exchange systems. A previous study, conducted for DoD by the Logistics Management Institute in July 1968, arrived at basically the same conclusions -- consolidating the exchanges would eliminate redundancy and result in significant cost savings. That study recommended the exchanges be consolidated. The study noted that multiservice exchange operations worked well in Vietnam where AAFES provided support to all Services and they are working well on a much smaller scale in various other parts of the world today, such as in Okinawa where AAFES exchanges support all services.

Given the complexity of the merger and the uncertainties of the future, a phased approach should be adopted. Each exchange system is in the process of implementing critical phasedown actions to meet anticipated force reductions and base closures, and these independent efforts should continue as planned, but coordinated among the Services. Managing these changes, while at

the same time attempting to consolidate into a single exchange system, would compound problems currently being addressed and increase the risk of adversely affecting customer service and earnings.

There are, however, potential savings from cooperative efforts that could be instituted immediately, and possibly the first step toward consolidation, which would result in savings and increased efficiencies within the overall exchange system. Additionally, such cooperative actions would begin to create the rapport, trust and working relationships needed to move to the total consolidation mode. Examples of such cooperative efforts, further discussed in the individual study chapters, include:

o Facility design and construction.

o Centralized distribution of specialized merchandise such as pre-recorded music and fine jewelry.

o Consolidated development and procurement of in store electronic point of sale systems and other ADP equipment.

o Transfer of operational support for exchanges based on the dominant system within a geographical area.

o Consolidated European purchasing.

o Quality assurance lab inspections.

o Shared in-house fast food concepts.

o Cross stocking of private label merchandise.

Due to the direct relationship between exchange and MWR programs, and the unique quality of life aspects of the exchanges, it is vital that the military Services continue to have direct control over the exchange system. This could best be accomplished through a joint board of directors, with a chairperson that rotates between the Army, Navy and Air Force, and full representation from each Service. Recommendations regarding the composition and responsibilities of such a board along with a proposed organizational chart are attached in Figure 1-3.

The exchanges are "cooperatives." Ownership belongs to its customers, not a "Government agency." The Board represents the customer base: soldiers, sailors, marines and airmen. The Board is a caretaker of the Service member's monies, revenues earned by the military exchanges, and, as such, has a fiduciary responsibility for the Service member's investment. It is the Service member's money, not taxpayer money, to be distributed as dividends to the services.

The Board, as a responsible military governing body, must report through the respective Chiefs to the Services'

Secretaries, not through a separate Government agency. This is in keeping with the role of the military exchanges and the Command's role to maintain and provide for the Morale, Welfare and Recreation of the Service member.

One of the major concerns of the Services during this study was the impact of consolidation on earnings and the availability of funding for MWR programs. The pro forma analysis in Chapter 3 indicates earnings would increase under consolidation, but a new dividend distribution policy would be necessary to ensure balance between support to MWR and exchange reinvestment and also consideration of existing assets of each Service. Any distribution method developed by the Board of Directors should consider ways to provide incentives for installation Commanders, to increase total exchange profits and avoid unnecessary competition with MWR.

The Navy Lodge Program, Navy Clothing and Textile Research Facility and Navy Ships Stores Afloat Program are unique entities to the NAVRESSO resale organization. These programs are vital elements of the Navy's quality of Life and shipboard MWR initiatives. They should be transferred internally within the Navy. Additionally, only traditional exchange functions from the combined Marine Corps exchange organization should become part of the consolidation.

The major savings from consolidation result from merging and reducing overhead staffs; centralizing procurement, accounting and construction functions; and eliminating duplicative warehouse and distribution activities. Very little change would be visible at the store operating level, with very little impact on customer service. In fact, by taking the best programs of each system, patron support should improve. With Service identity of the exchanges, Customer Service should improve. Service identity could be retained through signing or other actions, similar to what is currently done with the Army "PX" and Air Force "BX" under AAFES. Furthermore, there is no reason to believe local exchanges would not continue to be responsive to, and support, the desires of local commanders.

RECOMMENDATION

The study group recommends that the military exchange systems be consolidated into a single organization in order to eliminate current redundancies, improve operational efficiencies and achieve projected annual savings from consolidation of $35 million plus a $9.6 million future reduction to Navy and Marine Corps Store staffing from implementation of the AAFES Store Automation Program (ASAP). The following elements should be included in the implementation plan for the consolidated exchange system:

o A Joint Exchange Consolidation Task Force should be established to prepare and execute

necessary implementing plans and documents; to review and coordinate major Service initiatives during the implementation period, ensuring they are in consonance with the consolidation effort; and monitor the completion of required actions.

The task force would be responsible for overall consolidation planning and execution. It should be made up of senior functional area representatives, detailed from each exchange system, and assisted as necessary by additional staffing on a temporary basis. The first objective of the task force would be to develop a comprehensive implementation plan addressing impact, interface and required actions in each functional area, thus providing the blueprint for the future. In addition to functional area interfaces, the plan should also include:

- Proposed structure for the new exchange system, staffing requirements and command and control relationships.

- Procedures for a review of Service initiatives to assure they complement the consolidation process.

- Milestones and time frames for accomplishing identified tasks.

- Checkpoints for review and evaluation of consolidation progress to confirm proper direction prior to moving from one phase to the next.

- Programs and open communications lines to educate and assist employees.

- Requirements for changes in regulations and other regulatory documents.

- Identification of a test site to validate implementation procedures.

o Early implementation of cooperative efforts discussed herein, such as consolidated MIS procurement, centralized design and construction, centralized distribution of specialized merchandise, etc. should be to achieve initial savings and establish interface between the systems. Many of these offer substantial benefits, and could be implemented independent of any action on this study's recommendation. Besides the potential benefits from these programs, they would provide another mechanism for communications and cooperation between the existing exchange systems.

o A review should be conducted at each implementation phase to ensure the correct course is being followed and projected benefits can be achieved.

o A Board of Directors representing all Services, and responsible to the Service Secretaries, should be established to govern the consolidated exchange system and to manage and control what is, in effect, the

Service member's money and quality of life vehicle. This board would initially serve as an Exchange Consolidation Oversight Committee to guide the consolidation process. Since this board will become the governing body of the new consolidated exchange system, serving as the oversight committee will facilitate the transition to the consolidated organization and assumption of its responsibilities. Furthermore, interface with existing exchange boards will be facilitated since most consolidated board members are also directors of their respective exchange systems.

In addition to the major recommendation presented here, each functional chapter which follows has additional recommendations which, when implemented, will result in increased efficiencies, reduced costs and better customer service.

Closing

As stated earlier in this chapter, there are many uncertainties facing the exchange systems and any rash action regarding consolidation should be avoided. It is the opinion of this study group that, upon approval of the recommendation to consolidate the exchange systems, adequate time must be afforded for the development of a detailed plan prior to implementation. It would take two to three years beyond the actual implementation date before all implementing actions could be realized. A measured logical, methodical approach must be taken to minimize disruption to the existing work force and service to patrons.

For the transition to a new Joint Service Exchange Instrumentality to be successful, the support and commitment of all affected parties is essential. This commitment, which must be clearly communicated throughout each exchange system, should emphasize the overall benefits of such a consolidation to both employees and customers. Without total support, the transition could be plagued by serious problems which might adversely affect customer service and earnings.

Figure 1-2. Cost/Benefit Analysis, one-time Implementation Cost and Personnel Impact Summary.

Cost/Benefit Analysis

Item	Savings Cost Avoidance	Additional Cost
Current costs of HQ, distribution, accounting & buying function to be deleted	$116.28M	
Augmentation of HQ, distribution, accounting & buying positions under consolidation		$77.75M
Other Economics	8.84	
Other Costs		3.67
Totals	$125.12	$81.42M
New initiatives under Status Quo	(9.10M)	
Net Annual Impact of Consolidation	$34.6M	
Navy & MARCORPS Store Reductions resulting from ASAP	$9.6M	

* Cost/Benefits stated in relationship to FY 89 operations.

One-time Cost/Benefit (Implementation)

Item	Cost	Cost Avoidance
Personnel Relocation/ Severance Costs	$21.01M	
Training	13.42	
Other	.41	$1.80M
Management Information System	37.87	$60.10M
Total	$72.71	$61.90M
Net Cost	$10.81M	

Personnel Impact

	UA	HPP
Positions Affected	1348	2285
Relocate/Locally Place	379	589
Early Retirement	270	58
Reduction Action	699	1638
New Organization HQ Requirement	380	300
Store Augmentation Requirement	*	*

* Not identified by number or category of personnel, estimated annual personnel cost $13.3M

UA - Universal Annual
HPP - Hourly Paid Person

BOARD OF DIRECTORS

Board Responsibilities

The board should be responsible to the Secretaries of the Army, Air Force and Navy through the Army and Air Force Chiefs of Staff, Chief of Naval Operations, and Marine Corps Commandant in directing the exchange service. Basic responsibilities should be:

- Determine and approve policies, plans, programs, and strategies of the exchange system. Ensure appropriate staffing with departmental, other Service, and OSD entities.

- Review and approve operating and capital budgets and financial goals. Ensure they are consistent with the organization's strategies and policies.

- Set dividend policy and declare dividends to be paid to each Service's MWR function.

- Analyze reports on the exchange's performance and suggest possible actions to improve performance.

- Formulate policies regarding ethical or public responsibility matters and ensure organization adherence to these policies.

- Provide an annual report on exchange operations to the Service Secretaries.

- Provide the Army and Air Force Chiefs of Staff, Chief of Naval Operations and Marine Corps Commandant quarterly reports on the status of the exchange system.

Committees of the Board

Due to the scope of responsibilities, the board should rely on standing committees to accomplish detailed reviews of the issues and make recommendations to the board. There should be a minimum of three standing committees:

- Finance committee

  -- Review and recommend approval of financial policy and plans.

  -- Review the financial performance of the organization.

  -- Approve the level of funding available for capital improvements.

- Audit committee

  -- Review the audit program of both the internal auditor and external independent auditor.

  -- Ensure that managerial and accounting controls are adequate and effective.

  -- Promote practices to improve management efficiency and effectiveness.

- Capital improvements committee

  -- Review and recommend approval of capital improvements at a dollar level not to exceed that approved by the finance committee.

FIGURE 1-3 continued

Board Membership

Recommended membership is as follows:

- Army
  -- Comptroller of the Army
  -- Commander, U.S. Army Community and Family Support Center
  -- Sergeant Major of the Army
  -- Operational Commander selected by the Chief of Staff of the Army

- Air Force
  -- Principal Deputy Assistant Secretary, Financial Management (Resource Management)
  -- Assistant Deputy Chief of Staff/Personnel for Military Personnel
  -- Chief Master Sergeant of the Air Force
  -- Operational Commander selected by the Chief of Staff of the Air Force

- Navy
  -- Deputy Chief of Naval Operations for Logistics
  -- Commander Naval Military Personnel Command
  -- Master Chief Petty Officer of the Navy
  -- Operational Commander selected by Chief of Naval Operations

- Marine Corps
  -- Assistant Chief of Staff for Manpower and Reserve Affairs
  -- Sergeant Major of the Marine Corps
  -- Assistant Chief of Staff for Installations and Logistics
  -- Operational Commander selected by the Commandant of the Marine Corps

- Exchange system Commander

Chairmanship of the board should alternate between the Comptroller of the Army, Principal Deputy Assistant Secretary of the Air Force, Financial Management (Resource Management), and Deputy Chief of Naval Operations for Logistics at two year intervals.

FIGURE 1-3 continued

CHAPTER 2

CURRENT EXCHANGE SYSTEMS

OVERVIEW

A system to provide for the sale of non-issue personal use items to U. S. Military personnel dates back to the Revolutionary War. Over the years similar systems have evolved within the Services, with their current primary mission being: (1) To provide patrons with articles and services necessary for their health, comfort, and convenience; and (2) To provide a supplemental source of funding for military Morale, Welfare, and Recreation (MWR) programs. Today the exchange systems on military installations are big business, encompassing full service retail stores, food activities and a broad range of personal services. Combined annual direct sales of $8.4 billion, concession sales of $880 million and earnings of over $456 million -- all of which is returned to the servicemember through contributions to MWR or in the form of new and improved facilities -- make the exchange systems major retail organizations.

The exchanges, however, play

a much larger role than that of being strictly a business organization. They are also viewed as a significant influence on quality of life and as an important servicemember benefit, providing a form of non-pay indirect compensation. Based on surveys of off-base retail prices, exchange patrons enjoy an average savings of over 20%. Exchanges also provide vital support to servicemembers stationed at small remote and isolated areas -- even if these exchanges must be operated at a loss.

Since exchanges are nonappropriated fund activities and operate similar to commercial organizations, with merchandise, personnel and operating costs paid for out of sales revenues, cost to the taxpayer in the form of appropriated funding is minimal.

This chapter explains the military exchange organizations as they exist today. The first section contains a brief history of the evolution of exchanges over the years. This is followed by a summary of overall operations, designed to give the reader an idea of the range and scope of exchange programs. A brief analysis of each exchange system is then presented, identifying organizational structures and unique operating philosophies and procedures.

HISTORY

The military exchange history in the United States dates back to 1776 when Congress authorized civilian sales concessions to be established so General Washington's Continental Army could purchase items for personal use, such as tobacco, soap, and razors. Because of corruption, these concessionaires, or "sutlers" as they were more popularly called, were replaced in 1867 by post traders. The War Department contracted with these traders to sell non-issue items to servicemembers on military installations.

With westward expansion, Army personnel formed social clubs called "canteens", which sold ordinary items without profit. In 1889 the War Department published rules and regulations for the operation of post canteens, thus putting the post traders out of business. Then, on July 26, 1895, the War Department published General Order No. 46, setting the standard for the concept and mission of the modern exchange service.

Within the Army, exchange operations were established at the various posts with little or no direction from higher headquarters. Post commanders decided how earnings were spent.

This system remained unchanged until 1941, when the Army Exchange Service was established to provide broad

policy guidance for worldwide operations.

After the Department of the Air Force was established in 1947, the exchange became a joint operation. The Army Exchange Service was redesignated Army and Air Force Exchange Service in 1948. In 1972, the CONUS and overseas exchange operations were integrated into today's worldwide command.

Navy and Marine Corps exchanges followed a similar evolutionary path, which dates back to the time the Navy itself was established. In the early days, no means were available for providing sailors with basic personal necessities incident to living aboard ship. Instead, they had to make do with two poor sources of merchandise -- bumboats and canteens. Bumboats were small vessels that came alongside the Navy ships and exchanged their merchandise by means of pails lowered over the side by the crew. Canteens, on the other hand, were cooperative ventures, financed by the crew of each ship, which carried tobacco and other items the crew desired to purchase.

In the mid 1800's, the Navy migrated from a sailing Navy to a steam Navy, and coaling stations were established at all major ports. With this development, shore-based exchanges were soon operating at major bases in the U.S. and overseas.

The Navy Resale System was created in 1946 to manage all the major resale programs -- Navy exchanges, commissaries and ships stores afloat. Today, Navy exchanges have progressed substantially, and now include modern shopping malls, franchised and direct food activities, personal services and convenience stores.

With Marines serving as part of the ship's company and guarding Naval installations, the wants and needs of Marines were initially served by the Navy. Because of the increased size of the Marine Corps by 1897, however, separate Marine Corps exchanges were authorized and established, the first being at Marine Barracks, Boston. The Marine Corps exchange organization, designed to provide exchanges for combat units, successfully activated and used exchanges during all military conflicts to support assigned personnel.

In 1988, the separate Marine Corps MWR organizations and Marine Corps exchanges were merged into a combined MWR Activity at each installation and at Marine Corps Headquarters. Today, the Marine Corps exchange system is a modern retail organization operating at Marine locations both within the U.S. and overseas.

The exchange systems and their stores are instrumentalities of the federal government and are therefore subject to pertinent directives issued by the Department of Defense and the military departments. Congressional oversight is provided by the House Armed Services Committee, which establishes categories of merchandise and price limitations

on goods sold by the exchanges in the U.S., determines types of businesses that exchanges can conduct, and approves major construction plans.

SCOPE OF CURRENT OPERATIONS

Each of the three exchange systems have an extensive variety of operations to satisfy their dual mission. Broad policy governing operations is established by the Department of Defense, with detailed operating procedures developed by each exchange system. Although their operations are basically similar, differences are noted based on service-unique requirements and structuring. Each system is discussed in further detail later in this chapter.

Figure 2-1 shows the breadth of exchange operations, giving the number of separate retail, food and personal service activities within each exchange system. These activities vary in size based on the requirement of the individual location. Both direct and concession operated sales outlets are used to meet demand and fulfill the needs of the patrons.

Exchange operations exist in the United States and in over 25 foreign countries around the world. At small, remote sites, an activity may be marginally profitable or even operate at a loss; however, the decision to continue operation is based on meeting the needs of the service members assigned, rather than on a strict revenue decision. Exchanges are an integral part of an installation's MWR program.

Operating this wide range of facilities requires a large, dedicated workforce. Figure 2-2 and 2-3 provide a picture of current employee strength by category for each exchange service. It should be noted that a large number of employees are family members, with the exchange being the largest employer of family members on many military installations.

Figure 2-4 charts a five-year history of overall direct and concession sales for each exchange service. Figure 2-5 displays this same data for FY 89. Total earnings and payments to MWR for the five-year period is represented in Figure 2-6. Earnings retained within the exchange services are used primarily for capital programs, to provide for new and improved exchange facilities. A detailed financial and business analysis of sales, earnings and other comparison and measurement factors is contained in Chapter 3.

Each exchange service is an extensive world-wide organization, operating a multitude of separate businesses. While there are many similarities between each, the following outlines the major differences in organization and management philosophies based on

unique support requirements.

Command and Control

-- AAFES is an integrated command, whereby the exchange manager at installation level is responsible to, and is rated by, the exchange chain of command. The mechanism exists, however, for formal input into the rating system by the supported installation commander. The AAFES commander is responsible to the Army and Air Force Chiefs of Staff for overall mission accomplishment.

-- The Navy Resale Activity Officer in Charge (OIC) reports operationally to and is rated by the base commander. Additionally, a concurrent fitness report is prepared on the OIC by the cognizant NAVRESSO/Field Support Office (FSO) commander.

-- The Marine Corps exchange manager reports to the installation MWR Director, who is under the direct command of the installation commander. Technical guidance and support is provided to the manager through MWR Support Activity, headquarters Marine Corps channels, but direct command authority through HQMC does not exist.

Degree of decentralization

-- AAFES is generally considered to have centralized management, with policy and procedures and most supporting procurement, distribution, engineering, accounting and personnel management functions centralized at headquarters. An advanced communication and data processing system has been established to permit centralized operation.

-- The Navy system is semi-centralized, with the major support functions for the exchanges being performed on a regional basis by FSOs and Independent Resale Activities. Policies and procedures are established by NAVRESSO headquarters and many programs are centrally managed (i.e. such as private label and house brand merchandise, key sales promotions).

--The Marine Corps is considered decentralized, with the buying and other support functions accomplished at the installation exchange level. Policy and procedure guidance, as well as technical guidance and assistance, is provided by the headquarters staff element.

Composition of Activities

-- AAFES operations, almost exclusively, include only revenue generating retail, food and service activities on supported installations.

-- The Navy Resale Activity OIC is responsible for Navy Lodges, and Navy Uniform Centers located on the installation as well as the exchange retail, food and service operations. Until changes mandated by the Defense Commissary Store system comes into effect, the Navy OIC for resale remains responsible for the base commissary store. NAVRESSO also has the responsibility of

providing technical guidance and administrative assistance to the ships stores afloat program.

-- Within the Marine Corps, the exchange and MWR organizations have been merged into a single organization, structured to accomplish the total exchange/MWR mission.

Present AAFES System

The Army and Air Force Exchange Service (AAFES) is a joint Army/Air Force organization which operates over 14,000 exchange retail, food and service facilities on Army and Air Force installations in the United States and 26 foreign countries and overseas areas.

Additionally, AAFES operates the exchange facilities for the Marine Corps at Camp Fuji, Japan, and on all Marine Corps bases in Okinawa (where they draw the AAFES per capita MWR distribution from the Air Force). AAFES also provides limited exchange support to Navy and Marine Corps personnel at other locations, and provides bakery, dairy and ice cream support from AAFES plant operations to all Services' exchanges, commissaries, dining facilities and MWR activities in overseas areas where these plants are located.

The AAFES command structure is unique in that the general officer commander is responsible to a 15 member board of directors (BOD) established by the Secretaries of the two Services through their respective chiefs of staff (see Figure 2-7).

The AAFES command and deputy command positions alternate between the Army and Air Force, with one position filled by each service. AAFES itself is organized much like a military or major retail organization with a clearly defined chain of command down to installation exchanges, as depicted in Figure 2-8.

AAFES is organized on the principle of centralized management and decentralized operations. The directors of the four CONUS geographical areas and the two overseas exchange system (OES) commanders are responsible for operating all AAFES activities within their area, and are accountable to the Commander, AAFES. Similar responsibilities and accountability relationships exist between the area general managers and the regional directors/OES commanders, and between the installation exchange managers and the area general managers.

The AAFES Commander, establishes operating policies, goals and objectives for the organization. Programs that are standard throughout AAFES are developed and managed from headquarters. Region directors and OES commanders manage day to day operations following organizational policy.

The basic organizational outline of the AAFES operating elements and headquarters staff is shown in Figure 2-9.

The exchange manager (EM) is the senior AAFES representative on the supported installation, responsible for all AAFES activities there. The EM is responsible within the AAFES chain of command, however, because the EM's primary mission is service to the local installation/command, the EM is also a key member of the base commander's staff, and is generally included in all appropriate staff meetings, newcomers' orientations, advisory councils and other community meetings.

The EM maintains a close relationship with the base commander to provide service levels which meet the commander's quality of life (QOL) goals. Along this line, the EM coordinates exchange hours of operation with the commander, coordinates the long range capital program worksheets (identifying additional service requirements and improvements) and participates in base QOL programs.

Most AAFES management positions are filled with professional civilian executives. Of the over 84,000 AAFES employees, only 105 are military, filling designated management positions in AAFES headquarters and the OES commands. There are no military assigned at the exchange manager level.
AAFES' major support functions (purchasing, distribution, marketing, personnel management, accounting, engineering) are centralized at headquarters.

Information systems are centrally developed and managed to provide management at all levels with the data necessary to measure performance, identify deficiencies and take action when required.

Although operating policy is established by headquarters and support functions are centrally managed, decentralized operations give flexibility to individual stores to tailor stock assortments, hours of operation and other operational aspects to the needs of the community being served.

Most of AAFES' food activities are direct operations, including over 130 franchised Burger King outlets on Army and Air Force installations. In-house food concepts are centrally developed, directed and monitored to maintain desired standards. In the Services area, most AAFES activities are concession operated.

AAFES has an in-house engineering program for facility design and construction management.

A more detailed description and comparison of each functional element is presented in the chapters that follow.

Present Navy Exchange System

Organizationally, Navy exchanges are but one part of the total Navy Resale System, with a mission that parallels that of the other exchange systems.

The Navy Resale System is comprised of five separate, but related, programs. These programs are: Navy Commissary Stores, Ships Stores Afloat, Navy Exchanges, Navy Uniform Program and the Navy Lodge Program. All these resale programs are addressed in this study, except commissary stores, which are being consolidated with other commissaries into a new Department of Defense agency. Organizational entities of the Navy Resale System are:

-- The Navy Resale and Services Support Office (NAVRESSO), located in Staten Island, NY, which is the central management office for the resale system. NAVRESSO is an echelon three Naval command, operating under the Naval Supply Systems Command.

-- Field Support Offices (FSOs), which are regional offices established to provide support to Resale Activities in designated geographic areas.

-- Resale Activities, located on Naval installations and operating some or all four ashore programs, along with providing assistance and support to the afloat program. Some Resale Activities fall directly under the support provided by an FSO, while other Resale Activities operate independent of an FSO. Larger Resale Activities may provide support to smaller Resale Activities. Figure 2-10 provides a listing of FSOs and Resale Activities.

The Navy uses a semi-centralized management structure and command/control approach to fulfill the basic mission. A schematic of command and support relationships for the resale system/exchange operations is shown in Figure 2-11. Each of the eight regional FSOs are under the direct command of NAVRESSO, and provide support to resale activities within their designated area. This support includes procurement, administration, personnel management, automated data processing, distribution and accounting.

Navy Resale Activities, on the other hand, fall under the command of the local commanding officer where they are located. The commanding officer writes the primary fitness report for the Resale Activity OIC, and has command of exchange operations. Base commanders have the authority to review and approve budget requirements, organizational changes, the types of business or service to be provided, and their location and hours of operation. This reporting chain was established to enhance fleet and family support since the exchange supports the base mission and quality of life goals. The Resale Activity OIC also reports for additional duty (with a concurrent fitness report) to the commanding

officer of the cognizant FSO.

The Navy Resale System chain of command is predicated on military command and control, with military officers assigned as FSO commanding officers/ resale activity OIC. Within the resale system there are 13 officers and 83 enlisted personnel directly supporting exchange operations and 88 officers and 23 enlisted supporting exchange operations on a 50% basis (they are also currently responsible for supporting commissary operations).

NAVRESSO headquarters provides policy and procedures, operating manuals, directives, systemwide contracting and purchasing of merchandise, equipment, supplies, and services (where applicable), financial controls and guidance, and other services for operation of the 139 Navy exchanges, 82 commissaries, 376 ship stores, 113 Navy Uniform Centers and 42 Navy Lodges within the resale system. Figure 2-12 is an organizational chart depicting these responsibilities. In addition to the Exchange Operations Group, other functional elements supporting exchange operations include contracting, financial management, audit and inspection, facilities design and internal layout, human resources management, distribution management, merchandising techniques, data processing, information systems, sales coordination, security and legal counsel.

Navy Lodges are a separate program of the Navy Resale System. Lodges provide temporary accommodations for military families, and are discussed in Chapter 7 (Operations). Ships Stores, are appropriated fund activities authorized to make a profit to support shipboard recreation and general Navy recreation programs. Money generated through sales in a ships store also supports services that are provided free to the crew, such as laundry and dry cleaning, barber shops and other personal care needs. Also included in Chapter 7 is an analysis of the Ship Stores Afloat Program. The Navy Uniform Program is also an element of the Navy Resale System. It provides the sole source of authorized uniforms to all officers and enlisted personnel through 113 uniform centers and a uniform mail order program.

As stated earlier, the Navy Resale System is partially centralized. Most purchasing, accounting and other support functions are currently accomplished at the FSO level. However, NAVRESSO is in the process of determining management information system requirements which will permit greater centralization of some support functions. NAVRESSO is also in the process of consolidating regions (FSOs), which will result in fewer but larger distribution locations, as a means of further reducing costs.

In the food service area, sales are about evenly split between direct and concession operations, with most fast food operations being concession. Food sales have experienced negative

growth over the last two years, but action has been initiated to develop in-house food concepts and expand operations. In the services area, a high proportion of activities are operated direct rather than concession.

While NAVRESSO has an engineering staff, they use the Naval Facilities Engineering Command for design and construction management.

A more detailed analysis and comparison of the major functional areas and of financial data appear in later chapters of this study.

Present Marine System

The Marine Corps exchange system differs substantially from the other systems in that organizational structures both at the Headquarters and the respective field elements, manage the full range of MWR activities. The MWR Activity established at each major installation has the mission of administering, in a consolidated fashion, all MWR programs that: (1) provide active duty military and other authorized recipients with articles of goods and services necessary for their health, comfort and convenience; (2) provide athletic, recreation and leisure time activities for their mental, physical and social well being; and (3) provide dining, beverage and entertainment services. There has not been enough time since the exchange/MWR merger to accurately assess the effectiveness of the new combined organization.

Within this consolidated system, the Marine Corps operates a total of 18 exchanges. Figure 2-13 is a schematic showing the location of the 14 CONUS and 4 overseas (including Hawaii) exchanges.

The Marine Corps MWR System is operated under the direction of the Director, Morale, Welfare and Recreation Support Activity (MWRSPTACT), Manpower Department, Headquarters U.S. Marine Corps. Its management philosophy provides for a totally decentralized system. The MWRSPTACT Director issues general policy and guidance concerning patron driven MWR programs, and provides technical assistance to field commands. The MWR Policy Review Board at Marine Corps headquarters exercises broad oversight responsibilities, and acts as an advisory body to the

Commandant of the Marine Corps on MWR policy matters having a major impact on the Marine Corps. Responsibility for administration, management and operation of field activities is remains with the installation commander.

The MWR program at the Headquarters and field activities generally follow the organizational structure depicted in Figure 2-14. The four operational branches are:

- Retail Branch, which operates the retail activities (Marine Corp Exchange) and other designated resale services.

- Service Branch, which operates designated personal service selling activities.

- Food and Hospitality Branch, which operates designated independent service selling activities (Food Service, Lodging, Military Clubs, etc.)

- Recreation and Athletics Branch, which operates recreation and athletic programs at the installations. Support Functions (Personnel, Fiscal, etc.) throughout the MWR System may be found integrated into the operational elements or consolidated separately as depicted in Figure 2-14. Local commanders determine the organizational structure that provides optimum efficiency and responsiveness.

With decentralized operations, each exchange has its own buying staff and most procurement is made at this level. The buyers determine, through understanding the local patron profile, what merchandise should be carried, and ensure items of necessity and high demand are always in stock. The decision on whether a specific product or service should be carried is based on customer demand, prices and terms.

With this decentralized system, the exchanges also have the flexibility and independence to react and adjust to unique marketing opportunities. As an example, an exchange may embark on a niche marketing strategy rather than compete head to head if another Service's exchange is nearby. A higher fashion line and other select merchandise may be carried enjoying this strategy. The business strategy to "niche" market is not limited to decentralized operations, however, since a similar strategy can be accommodated under a centralized organizational structure.

Within the Marine Corps exchange system there are 7,026 employees, of which 126 are military (18 officers, 108 enlisted). At the installation level the exchange manager reports to and works for, the MWR Director, who in turn reports to the installation commander. Any problems of an technical or policy nature are surfaced to MWRSPTACT, Marine Corps headquarters. There is no integrated management information system with ties between headquarters and the exchanges in the field.

Food and services are also included in a typical MWR Activity on an installation. Prior to merging with MWR, exchange food operations were fairly evenly balanced between direct and concession. After merger, with resultant inclusion of exchange activities, clubs and other food facilities into the Food/Hospitality Branch, a greater proportion of the consolidated branch sales are direct. Name brand fast food, such as McDonald's, are concession and contracted for at the installation level.

Services operations sales are also balanced between direct and concession; however, the majority of operations are concession, with auto repair and vending being the major direct, operated activities.

The MWRSPTACT uses the Naval Facility Engineering Command for facility design and construction management.

The chapters that follow give a more detailed description and comparison of each major functional element of the exchange systems.

Number and Type of Exchange Activities (FY 89)
(Direct and Concession Operated)

	AAFES	Navy	Marines
Retail Facilities (Note 1)	4,111	374	174
Food Facilities (Note 2)	2,034	533	244
Service Facilities (Note 3)	6,335	1,095	406
Vending Facilities (Note 4)	2,151	251	210

NOTE 1: Retail includes Main stores, branch stores, shoppettes/seven day stores, four seasons stores, toylands, automotive retail, military clothing stores, Class Six/beverage stores, specialized retail store, etc. Excludes concession activities.

NOTE 2: Food facilities include cafeterias, snack bars, fast food concession and franchises, mobile food operations, other food services. Marine Corps figure includes all exchange and MWR food activities.

NOTE 3: Services include barber and beauty shops, laundry/dry cleaning, flower shops, appliance/electronic repair, optometry, pay telephones, car/equipment rental, automotive repair, photo processing, income tax preparation, tailor shops, theaters (AAFES), and other personal service activities.

NOTE 4: Vending includes product machines, amusement/game machines, washer/dryers (laundrettes), and other coin operated activities (Vending facilities are listed as separate activities, not individual machines).

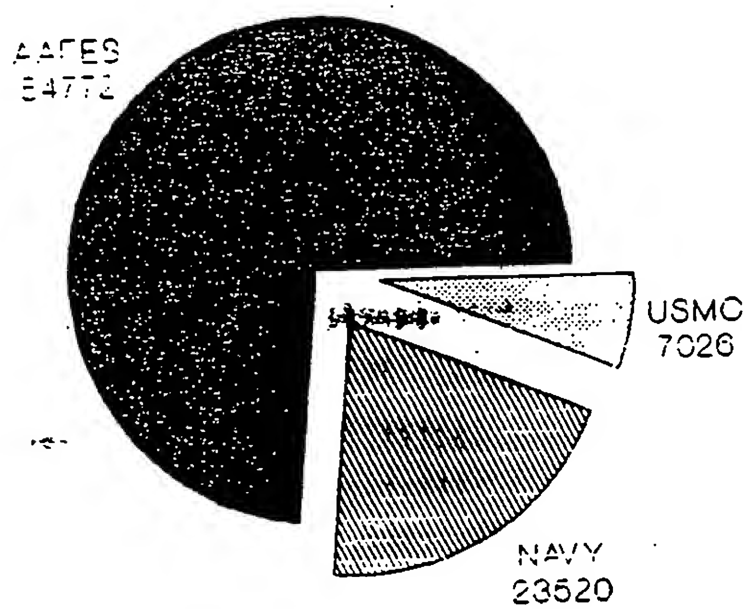
FIGURE 2-1

Assigned Personnel
(FY 89)

	AAFES	Navy Exchange	Marine Exchange	Total
Military				
Officers	80	57	18	155
Enlisted	25	94	108	227
Civilian (U.S.)				
UA	7,962	1,488	563	10,013
HPP FT	19,922	8,208	2,407	30,537
PT/INT	42,419	11,210	2,827	56,456
Local Nationals & Third Country Nationals	14,364	2,463	1,103	17,930
Total	84,772	23,520	7,026	115,318

FIGURE 2-2

Total Employees FY 89



Total Exchange Employees: 115,318

Figure 2-3

Total Sales ($ Billions)
(Direct and Concession)

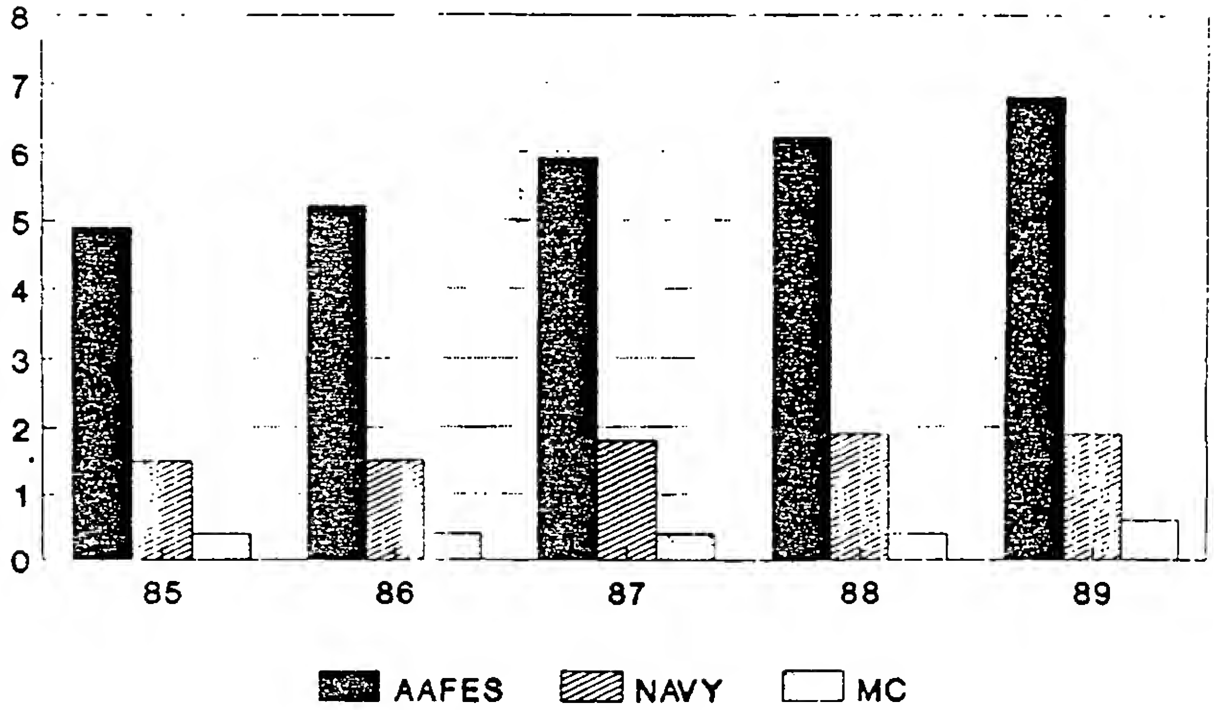
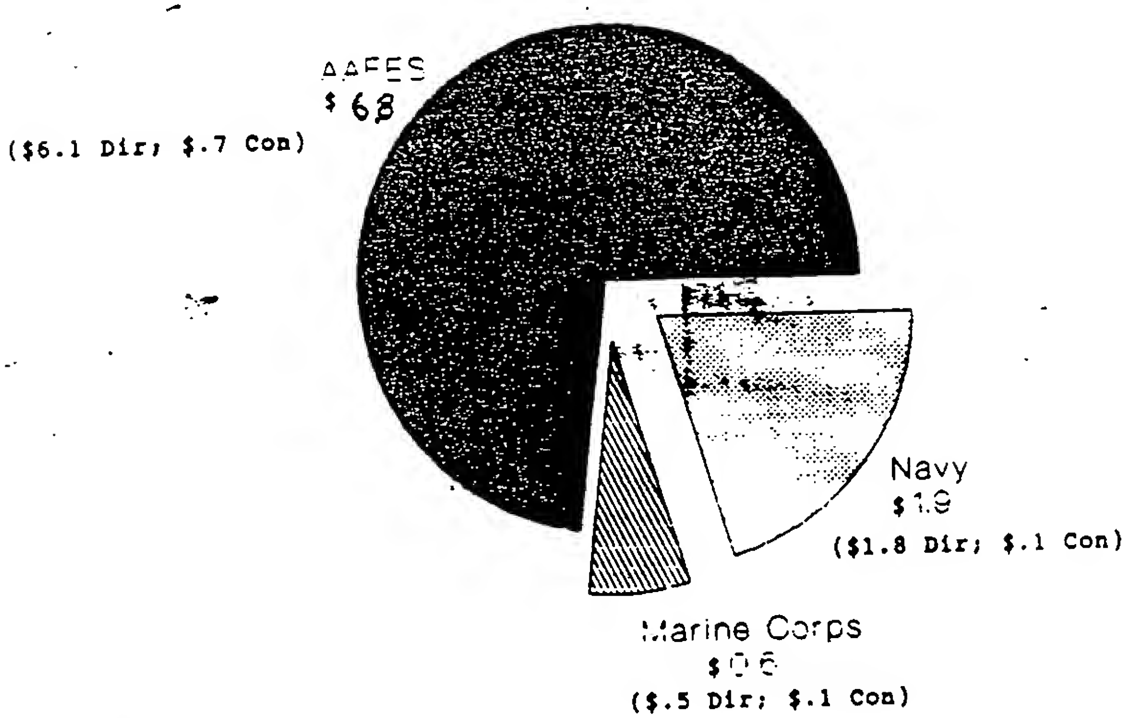


Figure 2-4

Total FY 89 Sales/Direct and Concession



MC is a consolidated exchange/MWR figure

Figure 2-5

Earnings and Payments to MWR
(in Millions)

		FY 85	FY 86	FY 87	FY 88	FY 89
AAFES	Net Earnings	$171.1	$228.9	$260.1	$230.8*	$351.4*
	Pymt to MWR	87.7	115.9	133.8	139.9	216.0
NAVY	Net Earnings	73.0	76.0	77.0	87.7	95.0
	Pymt to MWR	55.8	51.7	66.4	87.1	87.3
MARINES	Net Earnings	18.1	17.6	19.4	21.9	24.8**
	Pymt to MWR	15.2	15.1	15.9	16.8	**

* Includes pay telephone earnings not included in operating statements

** Marine Corps exchange operations were consolidated with MWR activities in FY 89.

FIGURE 2-6

AAFES Command Structure

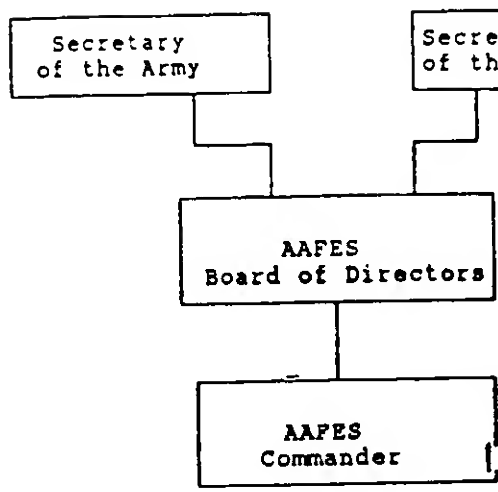


FIGURE 2-7

AAFES Chain of Command

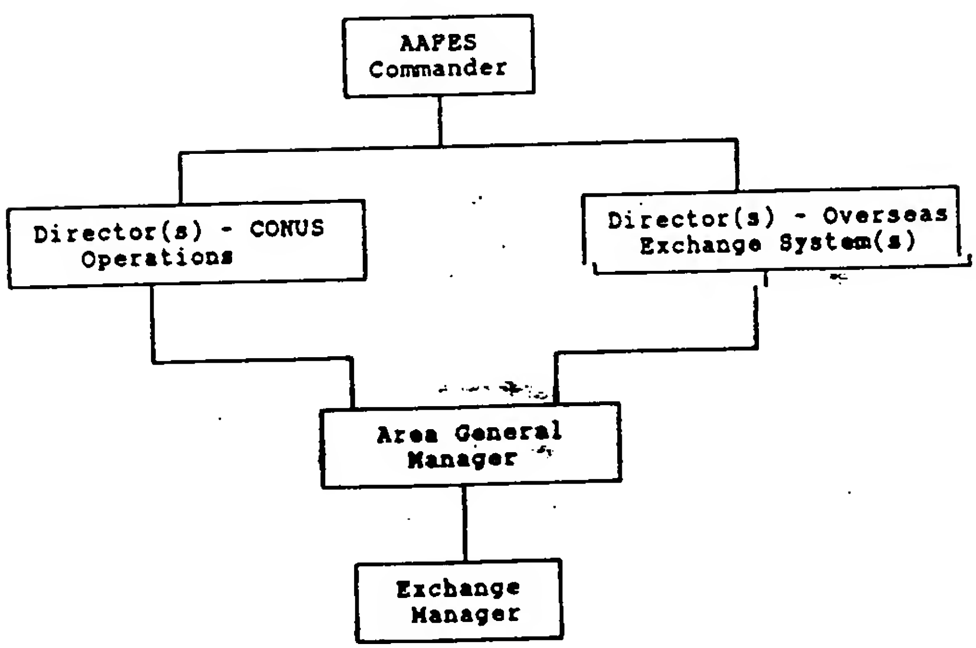
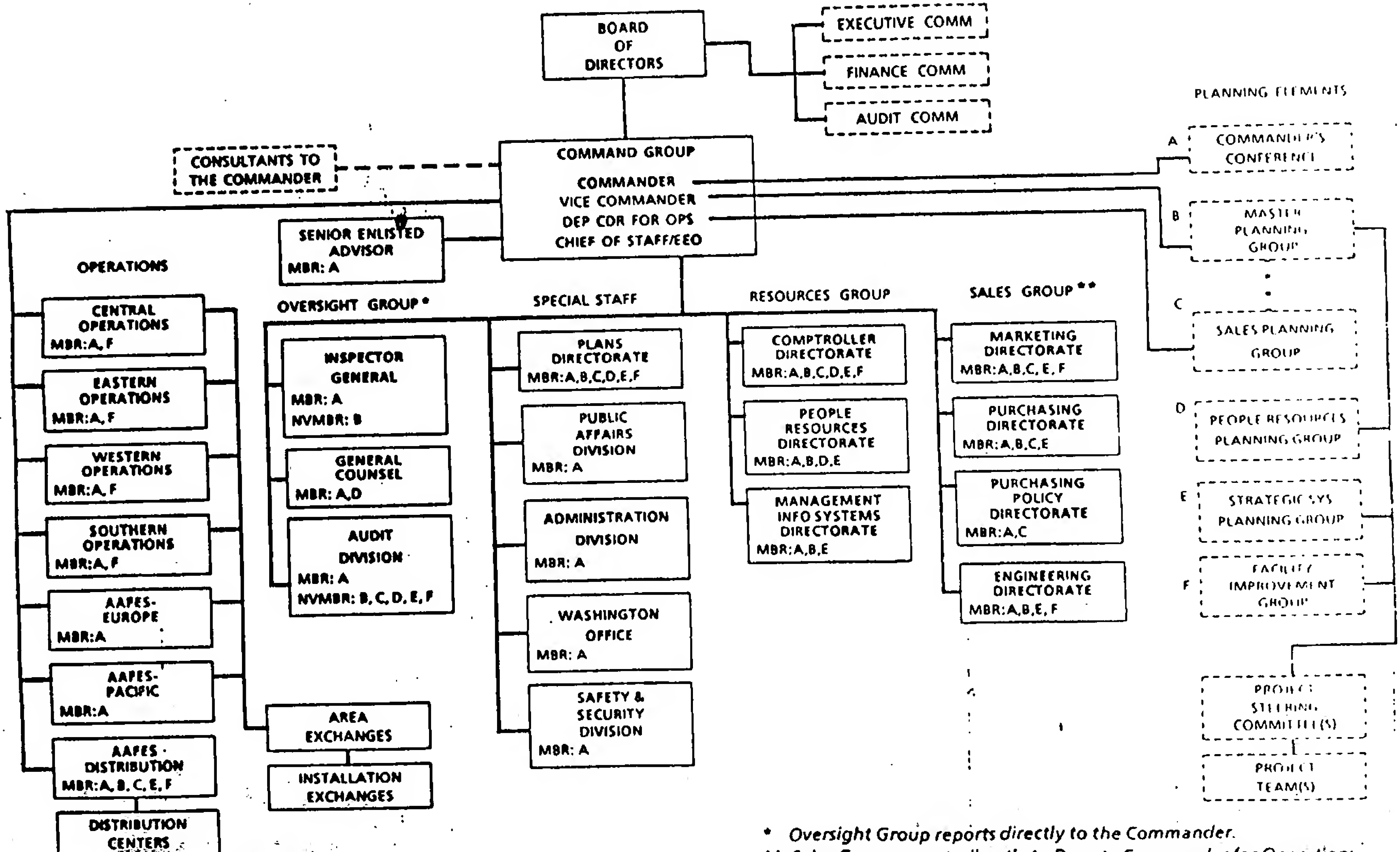


FIGURE 2-8

ARMY & AIR FORCE EXCHANGE SERVICE



* *Oversight Group reports directly to the Commander.*

** *Sales Group reports directly to Deputy Commander for Operations*

OPERATIONS

NOTE: ~~Region~~ representation on the facility improvement group rotates at the discretion of the chairperson.

Figure 2-10

NAVY FIELD SUPPORT OFFICES/INDEPENDENT RESALE ACTIVITIES

NEW YORK/NEW ENGLAND AREA
Field Support Office
North Kingstown, RI

Resale Activities supported:
NAF Argentia, Newfoundland
NSNY Brooklyn, NY
NAS Brunswick, ME
NCU Cutler, ME
NHA Mitchell Field, NY
NSB New London, CT
NETC Newport, RI
PNS Portsmouth, NH
NAU Scotia, NY
NSNY Staten Island, NY
NAS South Weymouth, MA
NSGA Winter Harbor, ME

PENNSYLVANIA/MARYLAND/NEW JERSEY AREA
Field Support Office
Mechanicsburg, PA

Resale Activities supported:
NS Annapolis, MD
NMC Bethesda, MD
NWS Colts Neck, NJ
NSWC Dahlgren, VA
NOD Indian Head, MD
NAEC Lakehurst, NJ
NSPCC Mechanicsburg, PA
NAS Patuxent River, MD
ASO Philadelphia, PA
NH Philadelphia, PA
NADC Warminster, PA
ND Washington, DC
NAS Willow Grove, PA

TIDEWATER AREA
Field Support Office
Norfolk, VA

Resale Activities supported:
NAS Bermuda
NSGA Chesapeake, VA
FCTC Dam Neck, VA
NS Keflavik, Iceland
NAB Little Creek, VA
NNS Portsmouth, VA
NRMC Portsmouth, VA
NRS Sugar Grove, W VA
NWS Yorktown, VA

GEORGIA/FLORIDA/SOUTH CAROLINA AREA
Field Support Office
Jacksonville, Fl

Resale Activities supported:
NF Antigua
NSCS Athens, GA
NAS Atlanta, GA
NH Beaufort, SC
NAS Cecil Field, FL
NH Charleston, SC
NS Charleston, SC
NWS Charleston, SC
NS Guantanamo Bay, Cuba
NAS Jacksonville, FL
NAS Key West, FL
NSB Kings Bay, GA
NS Mayport, FL
NTC Orlando, FL
NS Roosevelt Roads, PR
NSGA Sabana Seca, PR

SOUTHERN CALIFORNIA AREA
Field Support Office
San Diego, Ca

Resale Activities supported:
NWC China Lake, CA
NAB Coronado, CA
NAF El Centro, CA

NAS Imperial Beach, CA
NS Long Beach, CA
NAS Miramar, CA
NAS North Island, CA
NAS Point Mugu, CA
NCBC Port Hueneme, CA
NALF San Clemente Island, CA
NH San Diego, CA
NSB San Diego, CA
NTC San Diego, CA

NORTHERN CALIFORNIA AREA
Field Support Office
Naval Supply Center
Oakland, CA

Resale Activities supported:
NAS Alameda, CA
NSF Christchurch, New Zealand
NWS Concord, CA
NCS Exmouth, Australia
NAS Fallon, NV
NF Ferndale, CA
NAS Lemoore, CA
NS Mare Island, CA
NAS Moffet Field, CA
NPGS Monterey, CA
DODHF Novato, CA
NH Oakland, CA
NSC Oakland, CA
NSGA Skaggs Island, CA
NCS Stockton, CA
NS Treasure Island, CA

PACIFIC NORTHWEST AREA
Field Support Office
Auburn, WA

Resale Activities supported:
NS Adak, AK
NSB Bangor, WA
PSNS Bremerton, WA
NS Pugent Sound, Seattle, WA
NAS Whidbey Island, WA

HAWAII
Field Support Office
Pearl Harbor, HI
(5 Resale Activities supported)

INDEPENDENT EXCHANGES (CONUS)

Navy Resale Activity
(4 Exchanges)
Naval Training Center
Great Lakes, IL
Navy Resale Activity (independent)
Naval Air Station Memphis
Millington, TN

Navy Resale Activity
(8 exchanges)
Naval Air Station
Pensacola, FL

Navy Resale Activity
Naval Air Station
Dallas, TX

Navy Resale Activity
(3 exchanges)
Naval Air Station
Corpus Christi, TX

INDEPENDENT EXCHANGES

(OVERSEAS)
Guam - Mariannas
Italy - Naples (5 exchanges)
Japan - Yokosuka (4 exchanges)
Philippines - Subic Bay
(3 exchanges)
Spain - Rota (2 exchanges)
United Kingdom - England
(8 exchanges)

Command and Control Relationship
Navy Resale System

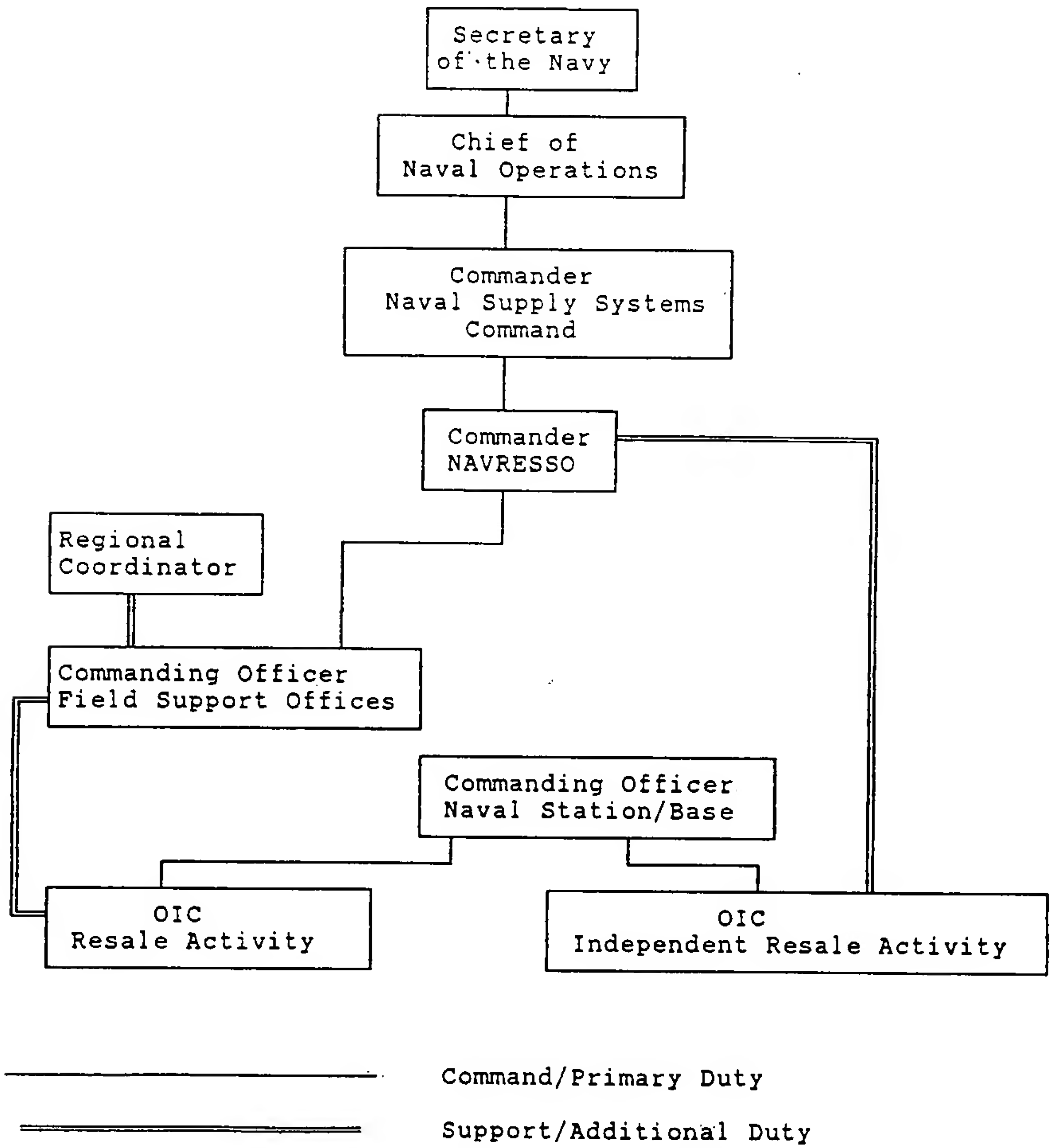
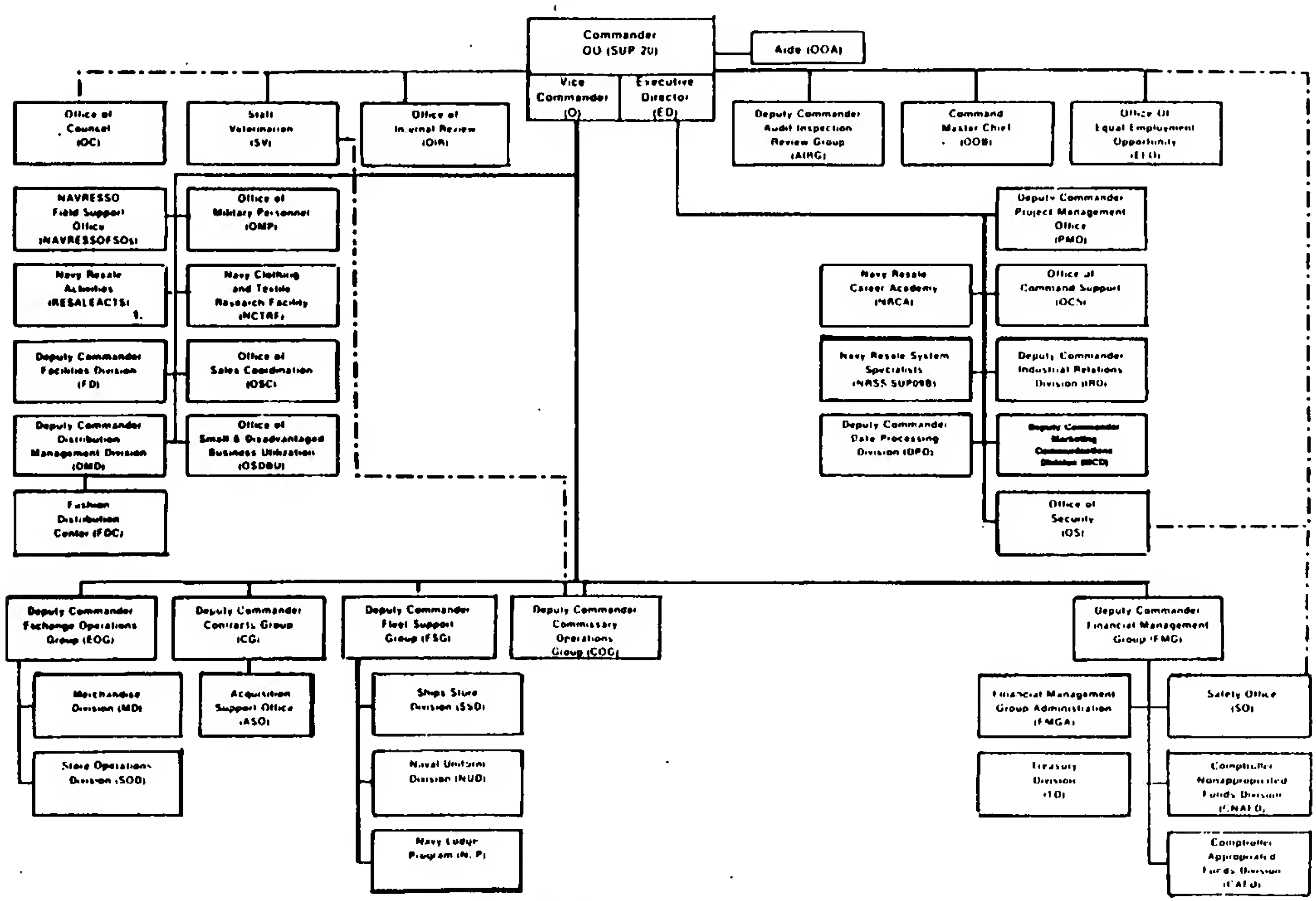


FIGURE 2-11

NAVY RESALE AND SERVICES SUPPORT OFFICE (NAVRESSO)



Date	Commander	Title of Field Activity	Title of Parent Organization
30 April 1980	Rear Admiral [illegible] Squibb SC USN	Navy Resale and Services Support Office	Naval Supply Systems Command

1. Primary support and technical control of Resale activities will be exercised by applicable NAVRESSO field support office. Primary support and technical control of independent Resale activities will be exercised through COMNAVRESSO. Those that are tenants of NAVMEDCOM activities will continue to report to their host for AD[illegible]

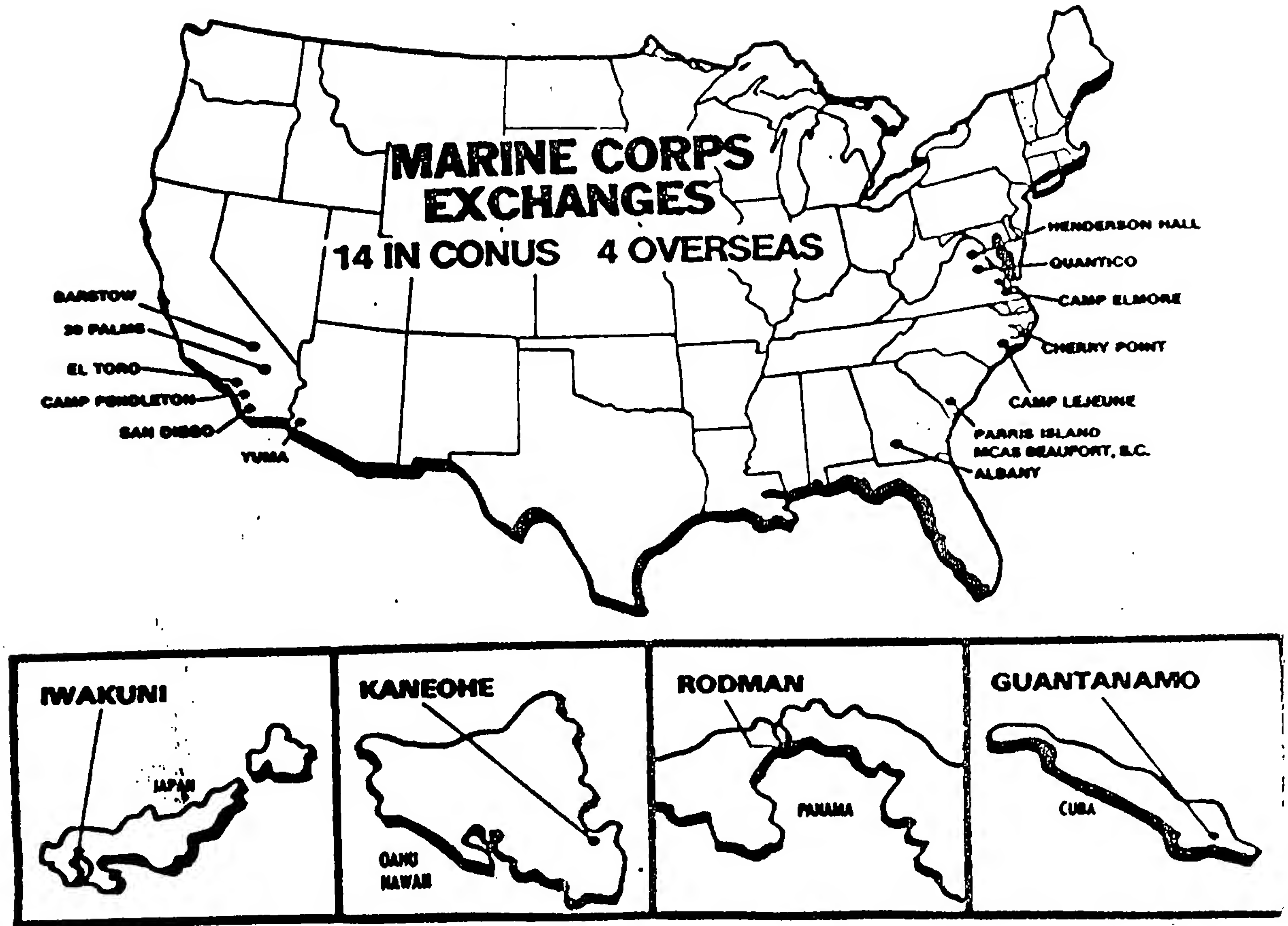

MARINE CORPS
EXCHANGES
14 IN CONUS 4 OVERSEAS
BARSTOW
29 PALMS
EL TORO
CAMP PENDLETON
SAN DIEGO
YUMA
HENDERSON HALL
QUANTICO
CAMP ELMORE
CHERRY POINT
CAMP LEJEUNE
PARRIS ISLAND
MCAS BEAUFORT, S.C.
ALBANY
IWAKUNI
JAPAN
KANEOHE
OAHU
HAWAII
RODMAN
PANAMA
GUANTANAMO
CUBA

FIGURE 2-13

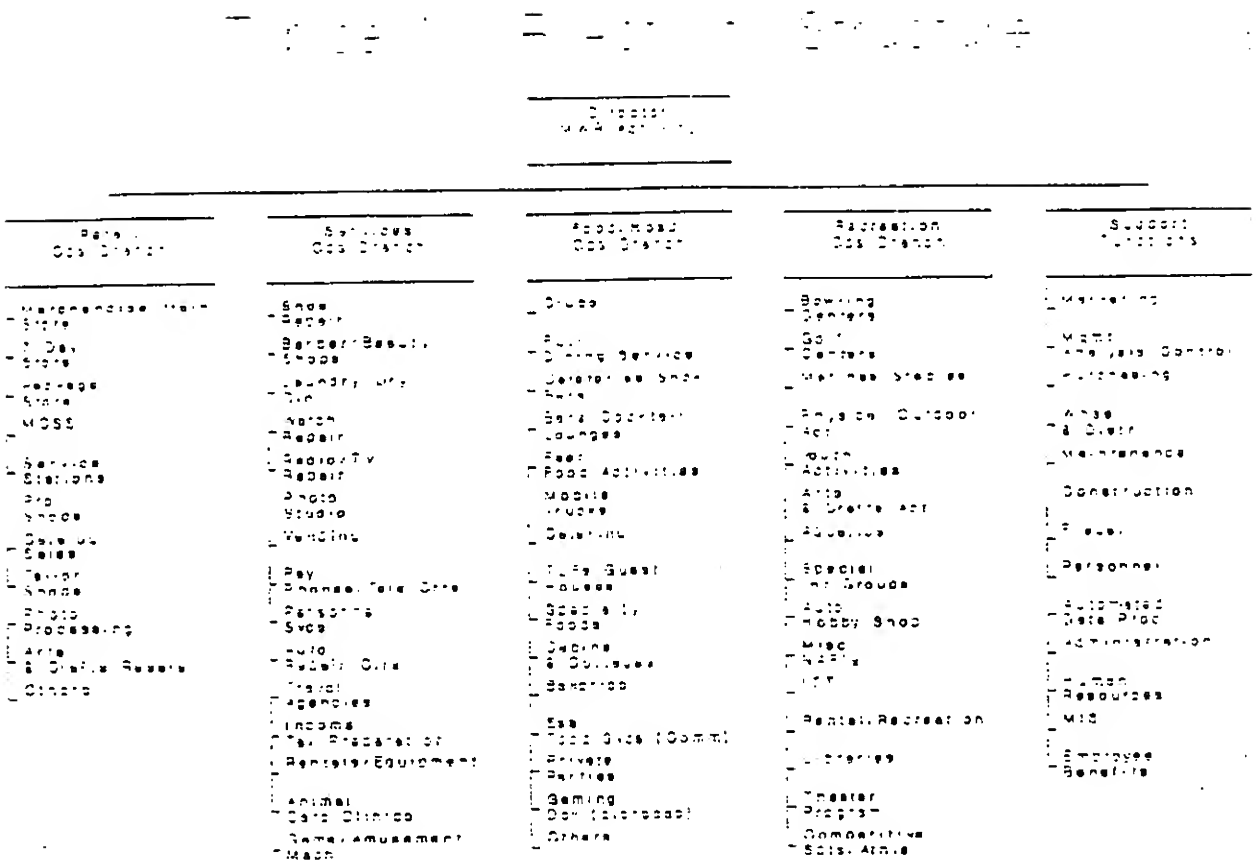

Service Stations
MOSS
Barber/Beauty Shops
Photo Studio
Vending
Pay Phones
Rentals/Equipment
Animal Care Clinics
Game/Amusement Mach
Fast Food Activities
Gaming
Others
Bowling Centers
Youth Activities
Special Int Groups
Auto Hobby Shop
Misc
Rental/Recreation
Theater Program
Competitive
Construction
Personnel
Administration
Human Resources
MIS
Employee Benefits

FIGURE 2-14

CHAPTER 3

FINANCIAL/BUSINESS STRATEGIES

SECTION 3-1 OVERVIEW

This chapter addresses issues that optimize performance through organizational efficiencies and increased earnings by cost savings and new income generation. It is organized into nine distinct sections.

- Section 3-2 reviews the overall military exchange financial performance as compared to commercial retailers. It describes the common and divergent business strategies each exchange system is pursuing.

- Section 3-3 provides a baseline definition of the separate financial systems as they exist today. It focuses on major functional areas such as the general ledger, accounts payable, payroll and financial management/treasury functions.

- Section 3-4 is a cursory review of the similarities and differences in the Services' MWR profit distribution policies and procedures.

- Section 3-5 analyzes each of the exchange systems with regard to their financial health. It focuses on profitability and liquidity ratios, an overall assessment using the Altman bankruptcy model and a review of the adequacy of each exchange systems' reserves.

- Section 3-6 describes the methodology used by the study group to support the recommendation for consolidated accounting.

- Section 3-7 reviews the organizational alternatives investigated by the study group.

It discusses planned initiatives associated with the status quo alternative. It also details the annual recurring costs and benefits along with the one-time costs associated with a total consolidation.

- Section 3-8 summarizes the impact of consolidation and significant events (such as troops draw down) on exchange earnings and subsequent impact to MWR and retained earnings.

- Section 3-9 summarizes the financial/business strategy recommendations.

SECTION 3.2 BUSINESS STRATEGIES

FINANCIAL PERFORMANCE

The military exchange systems are big businesses generating $9.3 billion in sales in fiscal year 1989 and ranking as the eighth largest general merchandiser in the United States.

Figure 3-1 MILITARY EXCHANGES - FY 89 SALES BREAKOUT

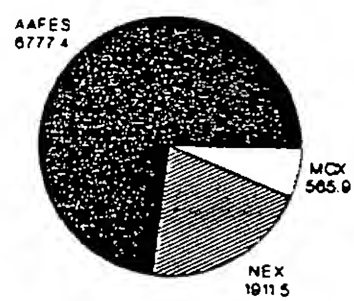
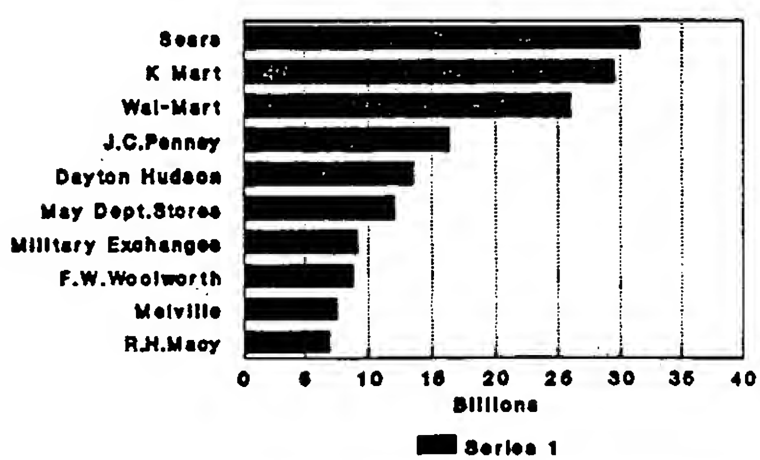


Figure 3-2 RANKING OF MASS MERCHANDISERS



While the majority of the exchange system sales are from traditional retail outlets, the exchange systems represent a highly diversified conglomerate of services and manufacturing activities.

They operate more than 15,000 customer service outlets worldwide comprised of such elements as outlined in Figure 3-3. In total, the exchange systems are comprised of seventeen separate businesses.

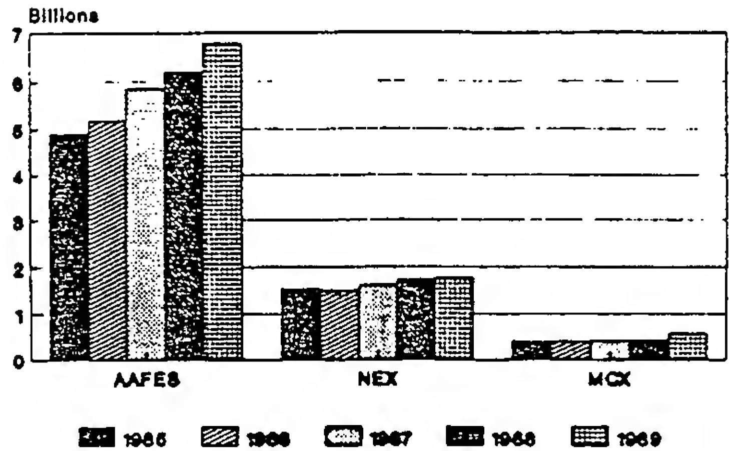
Figure 3-3 BUSINESS OF THE MILITARY EXCHANGES

- **MAIN RETAIL STORES**
- **CONVENIENCE STORES**
- **TROOP STORES**
- **AUTOMOTIVE**
- **FOOD OPERATIONS (NON-FRANCHISED)**
- **VENDING**
- **CLASS SIX/PACKAGE STORES**
- **SPECIALTY BUSINESSES...Catalog Sales...Commodity Concessions...Film Processing...Food Plant Operations...Franchised Food...Military Clothing Sales...New Car Sales...Personal Services... School Feeding...Theaters...**

The exchanges operate with a twofold mission: (1) to provide patrons with goods and services necessary for their health, comfort and convenience and; (2) to provide a supplemental source of funding for military Morale, Welfare and Recreation (MWR) programs. However, they represent far more than just a business entity, they are a major form of non-pay compensation to the service member, providing an average 20 percent savings from off-base retail pricing. They also play a major role in the quality of life of service members and their families. They provide vital support to service members regardless of where they may be located in the world, even if it means providing the service at a financial loss.

The exchange systems are restricted by the House Armed Services Committee as to the type of goods and services they may sell in the United States. The customer base is also essentially limited to active duty military and retirees and their family members, with limited shopping privileges for reservists and national guard members. In addition, the competitive nature of the commercial retail industry and the "overstored" marketplace has resulted in commercial retailers specifically targeting the military customer. Despite the limitations placed on the military exchanges and the highly competitive market in which they operate, they have achieved an overall 34.5 percent sales growth over the last five years.

Figure 3-4 MILITARY EXCHANGES - 5 YEAR SALES GROWTH



The exchange systems receive limited appropriated fund (APF) support, primarily in the areas of transportation of American made goods to overseas locations, utilities overseas and in designated isolated and remote activities and common base support services such as the maintenance of the structural integrity of the facilities in which the exchange activities are located.

In addition, the exchange systems have a limited number of military personnel who are assigned primarily in the areas of policy development and command and control. The most recent published information on the amount of APF support provided to the exchange systems is as of 30 September 1987.

Figure 3-5 APF SUPPORT TO MILITARY EXCHANGES

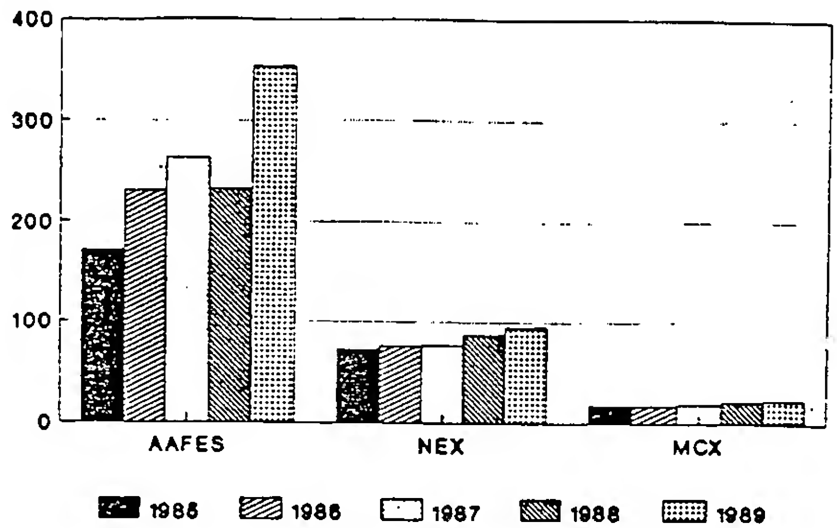
APF SUPPORT TO EXCHANGES

($ 000 - as of 30 Sept 1987)

	ARMY/ AIR FORCE	NAVY	MARINES
MILPERS	$5,572	$8,694	$5,366
Utilities	17,190	3,652	291
Communicat.	4,330	201	-0-
Maint/Repair	23,102	1,747	-0-
Supplies	140	5	-0-
Trans. People	409	-0-	-0-
Trans. Things	90,800	13,376	966
Other	16,094	174	398
TOTAL	$157,637	$27,849	$7,021

During the past five years, the exchange systems have generated earnings in excess of $1.7 billion of which more than $1.1 billion was distributed to the Services' MWR programs with the remainder reinvested in exchange capital programs.

Figure 3-6 MILITARY EXCHANGES NET EARNINGS GROWTH



COMMON BUSINESS STRATEGIES

The military exchange system is actually comprised of three separate organizations and, while the missions are identical, the strategies each system has chosen to pursue in the accomplishment of the missions are frequently different. Many of these differences reflect the geographic dispersion of exchange activities, the size of the organization or the command and control structure of the organization. However, many of the differences reflect distinct dichotomies in management philosophy of the fundamental way of doing business.

Prior to outlining the strategic differences between the organizations, it is appropriate to outline the fundamental strategic similarities; it is these which distinguish exchanges from most retailers. First and foremost is the absolute commitment to serving the military customer no matter where he/she is located. All retailers are committed to serving their customers, but not to the same degree as the military exchanges in that they will operate on an Alaskan mountain, in the Saudi Arabian desert, at a Cuban outpost surrounded by hostile forces, or in a combat zone. Carrying the distinction one step further, many of the locations where the exchange contributes most to the quality of life of the customers are not profitable operations.

The second strategic element which helps to define the consistency of exchanges, while simultaneously distinguishing them from other retailers, is the effort to fill a greater portion of the needs of more of the customers than most retailers. This is reflected not only in the breadth of services which the exchanges offer, but in the stock assortment carried in the various stores. A typical main exchange will carry the merchandise one would expect to find in a traditional discount department store, but also carries the name brand fashion merchandise, housewares and gift items you would expect to find in an upscale department store. In addition, they will carry such specialty store merchandise as audio and photographic equipment, fine jewelry and computers to name only a few. While exchanges are driven by the demographics of their specific geographic location, they do not have the option of selecting to serve only a portion of the customers as is true for commercial retailers.

All exchanges use, as a principal measure of their success, the amount of savings they provide their customers over commercial retailers. While the absolute savings provided by each exchange varies, they approximate the 20 percent level. Many discounters have adopted an everyday low price strategy to attract customers, but only the exchange systems have applied the philosophy to such a breadth of stock assortment and variety of services.

The final fundamental strategy pursued by all the exchange systems which distinguish them from other retailers is a pay-as-you-go philosophy. Unlike commercial retailers, exchanges finance even their physical plant out of current earnings. There is virtually no long-term debt among any of the exchanges.

In addition to the fundamental strategies shared by the various exchange systems, there are others of a less fundamental nature which are being commonly pursued. These include the use of name-brand fast-food operations and the use of electronic point of sale systems to provide inventory control information and to improve customer service by speeding up the check out process.

DIVERGENT BUSINESS STRATEGIES

While there are many similarities, the exchange systems are also pursuing separate strategies to accomplish their missions. What follows is a brief discussion of each.

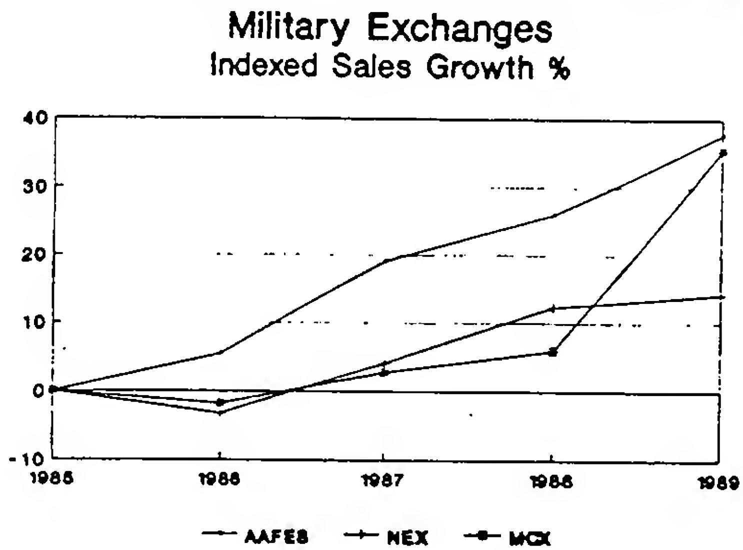
AAFES

The Army and Air Force Exchange Service (AAFES) is a consolidated exchange system which has served both the Army and Air Force since 1948 in the Continental United States (CONUS) and since 1972 overseas. AAFES strategies center around three principles; (1) they are sales driven; (2) they have centralized policy development and support services with decentralized execution and; (3) they retain significant funds to reinvest in the physical plant,

technology and infrastructure. Regarding the sales driven strategy, in 1989 AAFES sales and profits represent 73% of the total for the exchange systems even though their supported troop strength represents only 60% of the total.

However, a more effective measure of the effect of this strategy is reflected in Figure 3-7 which depicts the five year sales growth of the three exchange systems (the 1989 Marine Corps sales include consolidated MWR sales). The AAFES sales growth represents a 38 percent increase in sales as compared to a 18 percent increase in Navy Exchange sales.

Figure 3-7 MILITARY EXCHANGES INDEXED SALES GROWTH %



In order to achieve this sales performance AAFES has consolidated a number of policies, procedures and initiatives into a coordinated strategy with pricing and store operations the two major elements comprising the strategy.

Pricing

- Standardized pricing directed from headquarters with store management being authorized to reduce prices to meet local competition.

- High visibility items in selected categories priced to establish AAFES as the price leader even if the merchandise must be sold at or below cost.

- Introduced of house-brand and private-label merchandise to provide quality merchandise at desired entry price points.

Store Operations

- Extended store operating hours to accommodate the limited time available to the customer. Today, most all main exchanges operate from 9 a.m. to 9 p.m..

- Initiating Sales-Plus to provide increased customer services by staffing the sales

floor with more sales associates, reducing their responsibility for shelf stocking and increasing the number of management personnel to provide increased coverage and training.

- Development of the concept of convenience stores that include gasoline.

- Development of in-house fast food concepts.

The centralized management with decentralized execution

strategy continues to relieve local management of administrative and support responsibilities, which in turn allows them to concentrate on operations. This concept, along with technological advances in telecommunications, has resulted in the following initiatives that will reduce operating costs and improve customer service:

- Project Fresh Start realigns the CONUS operational structure from the field into four directorates for CONUS operations and a support center located in Dallas, TX. This relieves operating management of the responsibility for support functions and will reduce operating costs by $15.6 million.

- Realignment of the European Area Exchanges to the CONUS concept similarly relieves operations of administrative responsibilities and provides an additional $2.7 million reduction in operating costs.

- The first phase of the European Headquarters realignment is just beginning with the transfer of selected personnel and engineering functions to Dallas, saving $2 million.

Subsequent European Headquarters realignments, currently planned, coupled with anticipated troop draw down, will save approximately $16.9 million in overhead costs.

- Project Real, which realigns the AAFES distribution system, is in its final phase with the construction of the Western Distribution Center the last major element. Upon completion, AAFES will have a state of the art distribution/logistics network able to support customer needs throughout the world.

AAFES reinvestment strategy retains more of its earnings for capitalization of its physical plant and technology than the Navy and Marine Corps exchange systems. AAFES believes quality exchange facilities enhance the service member's quality of life while increasing patronage/sales, and state of the art support systems allows them to remain competitive and retain their sales base. The last five year total of earnings reinvested by the exchange systems were as follows:

Figure 3-8 FIVE YEAR EARNINGS/EXCHANGE REINVESTMENT

FIVE YEAR EARNINGS/ EXCHANGE REINVESTMENT

	Earnings Reinvest.	% Earnings
AAFES	$559M	44%
Navy	60M	14%
Marine Corps	19M	18%

NAVRESSO

The Navy Resale System is unique among the exchange systems in that it was created in 1946 to manage not only the Navy Exchanges but the commissaries and ships stores afloat as well. Today the system has been expanded to include the Navy Lodge Program and the Navy Uniform Program.

The Navy strategies as described in the 1988-1989 Navy Exchange Program Business Strategy, and updated by major on-going initiatives, center around: (1) increased emphasis on softlines while using consumables to enhance price image; (2) centralized policy guidance with regional support and; (3) enhanced management information systems.

The Navy Exchange set forth an objective in 1988 to "significantly increase the softline side of the business as a percentage of total business)," to enhance the fashion image of the business and to increase profitability. While softline sales have increased by 14 percent they remain consistent at 19 percent of total sales.

The Navy Exchange has initiated several facets of their softline expansion strategy which is expected to increase profitability while simultaneously enhancing service to the customer.

- The introduction and continued expansion of the Harbor View private-label products provide the customer with an excellent value while at the same time increasing profit margins.

- The recently introduced Kids Ahoy product line provides an outstanding opportunity to introduce the military parent to the long-term benefits of shopping the Navy Exchange while again increasing the profit margin.

- The strong presence of designer labels in the Navy Exchanges' soft lines stock assortment, coupled with the

regional buyer's ability to tailor the assortment to local demographics, clearly enhance the fashion image of the exchange.

While pricing is a local decision in Navy Exchanges, a new pricing program was introduced in 1990 aimed at

establishing the Navy Exchanges as a price leader by selecting specific high visibility items and pricing them below the local competition, even if it means selling below costs. Additionally, the Navy Exchange house-brand items provide quality products at entry price points below competition.

The Navy Exchange organization, with its central policy guidance and regional support functions such as buying, accounting and distribution, is a natural evolution of the geographic dispersion of Navy installations. It provides economies by eliminating duplication but still placing the support as near the operating level as economically feasible. Further economies are planned to be accomplished as follows:

- The Navy Exchange is pursuing a strategy to further consolidate it's support functions by reducing the current seven CONUS field support offices to three, saving $7.6 million annually.

- The present centralized accounts payable functions is being decentralized with an anticipated annual savings of $1 million.

- Case management and hospital bill audits are expected to save $0.5 million. Computerized store labor scheduling is also expected to save another $0.5 million.

Enhancement of the capabilities of the Navy Exchange information systems is an essential element of their overall strategic direction. The present systems and equipment are performing at maximum capacity with no capability to expand. The Navy Exchange plans to attain state of the art capability by purchasing off-the-shelf systems designed to support retail department stores and will modify their operations as necessary.

Marine Corps

The Marine Corps Exchange strategies, with the exception of name-brand fast food and the merger of exchange and MWR activities, are essentially developed by the local installation. However, the Marine Corps does adopt a niche marketing strategy when more than one exchange is located in close proximity.

The decentralized Marine Corps Exchange organization is a natural evolution resulting from the wide geographic dispersion of installations. While it offers the ideal environment to tailor products and services to local demographics, it doesn't allow for cost advantages of volume buys that are possible with a central distribution system. It also does not afford the opportunity to provide value alternatives of a major house-brand or private-label program.

The informal niche marketing strategy adopted at locations such as Henderson Hall allows the Marine Corps Exchange to capitalize on its local autonomy by analyzing the demographics of a particular market and its merchandise offerings and target selected groups of customers with higher gross profit merchandise. This not only generates additional earnings for Marine Corps MWR from the sale of the targeted merchandise but can establish the exchange as a destination store, thereby capturing additional sales that would normally be purchased at another exchange or commercial retailer.

SECTION 3.3
BASELINE DEFINITION OF FINANCIAL SYSTEMS

The current financial management systems for each exchange were reviewed. All systems are considered adequate. A brief synopsis, as provided by the members of the financial management study group, follows. The basic description includes organization and the major functional areas - general ledger, accounts payable, payroll, financial management/treasury functions.

NAVY RESALE AND SERVICES SUPPORT OFFICE (NAVRESSO)

<u>Organization</u> NAVRESSO includes six major programs. Nonappropriated funded programs are the Navy Exchange, Navy Lodge and accounting and services for the Military Sealift Command Exchanges. Appropriated funded programs are the Ships Store, Navy Uniform and Navy Commissary Program. NAVRESSO charges each program for its financial management costs. Fiscal functions are centralized at headquarters with field data input at eight field support offices (FSO's) and fourteen independent Navy Resale Activities (NRA'S)

<u>Major Functions</u>

<u>General Ledger</u>

- Tracks sales and costs from installation level through worldwide roll-up.

- Provides field management with preliminary data within six to eight days after the end of the month.

- Sales, gross profits and inventories by facility and department are available to field management.

- Interfaces with accounts payable, accounts receivable, sales audit, payroll, retail chain stores, etc.

- Permits mix of retail and service departments at a single facility.

- Interfaces with financial data base to permit download to personal computers for analysis.

- Capitalizes distribution center costs to installation level inventories

based on issues by department and installation. Tracks inventory movement at all levels of accountability.

- Generates comparative performance report by sales volume.

- Grouping provides roll-up of individual installation operating statements to a consolidated regional statement.

- Allocates FSO administrative overhead costs to installations.

- Produces full range of standard accounts receivable reports at installation and higher level consolidations. Produces customized dunning letters and invoices and handles multiple classes of accounts receivable.

- Produces standard fixed asset reports, interfaces with general ledger for depreciation and permits forecasting of depreciation expense.

NAVRESSO reports that the current weaknesses of the general ledger system are: file maintenance and headquarters processing is cumbersome; the system for headquarters is tape oriented and is a separate accounting system; the budget system is off-line; it permits "one legged" entries; it is missing query (but query-like feature is in financial data base); and networking from the field is inadequate.

NAVRESSO plans to replace the general ledger system with a standard off-the-shelf package. They are currently replacing the current fixed asset accounting system with a personal computer based integrated fixed asset/facility maintenance system at field level.

Accounts Payable

- Allows for both central and local payment of invoices. Decentralized payment of invoices places matching process close to order generating source and merchandise receiving functions to minimize cost of coordination and control.

- Tracks lost discounts and interest payments and allows for prepayment of overseas invoices.

- Interfaces with general ledger, merchandising, inventory and distribution systems and fully complies with the Prompt Payment Act requirements.

Payroll

- The Human Resource Information System (HRIS) is state of the art and interfaces with personnel. Both systems accurately calculate payroll, produce labor distribution, necessary tax reports, processing and file maintenance. Automated timekeeping is tied to a labor scheduling system.

NAVRESSO reports that while HRIS is state of the art, it cannot be expanded further. In addition, central payroll accounting processing and file maintenance is cumbersome and does not handle manual checks well. Checks are printed centrally vice at each activity and small overseas activities

are not on the main system.

Financial Management Treasury Function

- Cash management is centralized. A call-in system extricates cash from local banks for central investment. NAVRESSO's midwest concentration bank waives the 12% reserve requirement and credits interest earnings on 100% collected funds balance. A contractual ceiling on float time speeds cash availability for investment. Microencoders are used where cost effective to install to minimize bank fees. Dual concentration banks (one for CONUS activities and one for overseas) provides a reliable cost and service comparison.

- NAVRESSO has a $50 million revolving credit agreement that: has no commitment fee; has an interest rate based on the lower of three benchmarks (less than prime plus 1%); is available on short notice; and has maximum payback flexibility.

- Primary credit and collection effort is close to or at a base where the debt is incurred but procedures allow for headquarters staff to handle major problems. NAVRESSO uses Dun and Bradstreet's three step collection process, involuntary pay checkage and the IRS tax refund offset program.

- Experienced investment committee makes sound investments with reliable financial institutions through certificates of deposits, repurchase agreements, etc., in accordance with DoD guidelines.

ARMY/AIR FORCE EXCHANGE SYSTEM (AAFES)

Organization The fiscal functions are centralized within AAFES. Final records are maintained at AAFES headquarters with fiscal data input from accounting offices located throughout the world. One general ledger is maintained at headquarters. Financial statements are prepared monthly for each facility and consolidated at each management level. A single CONUS accounting office will be phased in between August 1990 and July 1991 to replace the four CONUS regional accounting offices.

Major Functions

General Ledger

- Mechanized central system processes standard financial statements by facility and each managerial level within 11 workdays after the end of the month. Produces an automated trial balance.

- Capitalizes distribution costs into inventory.

- Maintains inventory accountability by facility.

- Has immediate access to data systems support with no major processing delays.

- Monitors and controls delinquent accounts receivable to include organizational accounts; collection of individual dishonored checks; and centralized processing and reconciliation of 10 million

credit card transactions annually to ensure timely receipt of payments by the banks.

- Maintains fixed asset records by facility to include acquisition dates, book balances and accumulated depreciation by asset. Data are also summarized by categories of assets.

AAFES reports that current fiscal data input is not at the source, requiring the movement of documents to accounting offices for input. The AAFES Store Automation Project (ASAP) is in development which will permit data entry at the source. This project is intended to be operational within three years. Management does not have on-line access to fiscal data. ASAP and the Integrated General Ledger Accounting System (IGLAS) will provide on-line access to daily and period-to-date fiscal data.

Accounts Payable

- Centrally audits and pays vendor invoices for goods and services purchased in the U.S. Resolves discrepancies with vendors and receiving elements. Centralized CONUS payable allows for uniform treatment of vendors; mechanized due date system for prompt payment; vendor requirement to deal with only one office; and complete payment history file is maintained.

- Controls due-dating of contractors payments and effects collection of funds due from CONUS contractors.

- Ensures cash discounts, anticipations and distribution allowances are taken.

- Monitors the purchase-in-transit account and effects follow-up and write-off of unresolved credit balances.

- Disperses all checks to U.S. vendors from headquarters.

- Overseas accounting offices perform local accounts payable functions.

Payroll

- Prepares bi-weekly payroll for U.S. dollar paid employees. Dispatches checks worldwide on the seventh day after the end of the pay period, except AAFES-Europe and outlying Pacific areas which are printed on site.

- Controls deductions and disbursements to the proper authorities, including state and federal taxes, payments for group insurance and 401K.

- Controls all state unemployment wages; issues wage and tax statements; and audits and processes PCS expense vouchers for U.S. employees worldwide.

- Interfaces with the personnel record to ensure accurate updating of employees' payroll records.

Financial Management Treasury Functions

- Cash management is centralized with mechanized funds transfer from 250 depository banks to concentration banks; ensures maximum fund utilization by

daily transfers, the day after the sales date.

- AAFES has a $500 million line of credit, permitting immediate borrowing capability based on competitive bids that result in very low interest rates.

- Mechanization of AAFES Deferred Payment Plan overseas ensures accurate maintenance of a $130 million in-house revolving credit system.

- AAFES is an Army Finance Office (and will become Air Force Finance Office in 1991) and can process involuntary pay actions. AAFES is mechanically tied into the IRS Tax Offset Program.

- Centralized administration of the credit card contract creates economies of scale that result in favorable fee structure and reduced costs.

MARINE CORPS

Organization. The Marine Corps organizational structure consolidates the exchange, club system and recreation operations under a single MWR activity. The consolidation began in September 1988 and was completed in January 1990. A single nonappropriated fund instrumentality (NAFI) is located at Marine Corps Headquarters and at each installation. The MWR single fund is composed of four operating groups (retail, services, food and hospitality, and recreation) and seven support functions (fiscal, personnel, automated data processing, administration, construction, marketing, and management analysis and control). The MWR activity does not include the following NAFI's: aero clubs, rod and gun clubs, dependent school cafeteria funds, rifle funds, chapel funds, civilian welfare and recreation funds, billeting funds and child care. However, these NAFI's do receive support services from fiscal and personnel offices.

Major Functions

General Ledger

- The MWR Activity at each installation is a single NAFI. The organization and accounting system are decentralized. Each NAFI that is supported by the accounting system is a "separate company" with a distinct balance sheet and operating statement. The accounting system is based on a cost center protocol that allows a variety of management reports. Each operating element is assigned a unique cost center which captures operating income and expenses, distinguishing performance at the lowest level, by location or operating sub-elements (e.g., service station A, service station B, service station A fuel, service station A parts, etc.).

- The balance sheets were completely merged at consolidation. Post consolidation accounting does not segregate assets with the exception of inventories and fixed assets. Facilities with an acquisition cost over $20K are reported and depreciated by headquarters rather than the field.

- The "company level" operating statement presentation is based on the local organizational structure. The statement segregates the retail, services, food and hospitality and recreation operating branch performance. Support function operations are displayed separately, not allocated to the operating branches. Headquarters assigns a responsibility reporting code to each cost center. This procedure ensures that cost centers are reported under the proper branch or support function to produce standard "company level" operating elements. The profit of each operating branch is calculated before support branch costs. Support costs are not allocated to operating branches. The field produces operating statements on their own, eight to ten days after the end of the month.

- The fixed asset subsystem identifies the cost center to which the assets are assigned. Depreciation is expended to that cost center.

- The profits of each operating branch reflect the impact of headquarters sales assessments. The sales assessment is three percent of sales for revenue generating activities. The assessment is reported as a direct expense of the operating branch. This unique accounting practice must be considered when conducting comparative analysis of profit distribution or operating performance. A discussion of the sales assessment and how MWR profits are distributed is contained elsewhere in this report.

- Accounts receivable are locally administered. The Marine Corps has a customized accounts receivable system for in-house credit (club membership, child care, etc.) which produces monthly statements (decentralized at installation level).

<u>Accounts Payable</u>

Accounts payable functions are decentralized, however about 50 percent of accounts payable checks are drawn on a centralized bank account administered by headquarters. The headquarters is reimbursed by sight draft on the installation's checking account.

<u>Payroll</u>

Payroll is done locally but certain information such as benefits aggregate centrally. Payroll interfaces with personnel.

<u>Financial Management Treasury Functions</u>

- Cash management is decentralized. The Marine Corps MWR doesn't have depository banks or a concentration bank account.

- Marine Corps does not use line of credit financing.

- The Marine Corps participates in the IRS Tax Offset program and pay checkage is used to the maximum extent possible. Both functions are decentalized.

- Although Marine Corps cash management is decentralized, about 73 percent of cash is invested by

headquarters. Only headquarters is authorized to invest in repurchase agreements. The Marine Corps investments are limited to certificates of deposits and government securities. The fiscal director of the Marine Corps, counsel for the Commmandant of the Marine Corps and the Director of MWR Support Activity act as the Investment Oversight Committee reviewing overall strategy and performance. Daily investment strategy is executed by the Comptroller, MWR Support Activity.

The Marine Corp has a central contract for Discover, VISA and Master Card using First National Bank of Atlanta for settlement.

SECTION 3.4 MWR PROFIT DISTRIBUTION

The methods used by AAFES, NAVRESSO and the Marine Corps Exchange Systems to distribute profits/dividend distributions to local installations, major commands and the central MWR Funds vary among the Services. Dividend distribution policy (the amount retained by the Exchange System for reinvestment and working capital and the amount provided to MWR) - is determined by a military Board of Directors and the respective Exchange System. Current agreements are discussed below. Five year earnings and payments to MWR are shown in Figure 3-9.

FIGURE 3-9 EARNINGS AND PAYMENTS TO MWR

Earnings & Payments to MWR
($ in millions - except per capita)

	FY 89	FY 88	FY 87	FY 86	FY 85
AAFES					
Net Earning	$353.8	$233.0	$263.9	$230.3	$171.1
Pymt to MWR	216.0	139.9	133.8	115.9	87.7
$ per capita	140.00	91.00	87.00	76.00	58.00
% to MWR	61%	60%	51%	50%	51.0%
NAVY					
Net Earning	95.1	87.7	77.0	76.0	73.0
Pymt to MWR	88.0	87.1	66.4	51.7	55.8
$ per capita	144.00	147.00	115.00	90.00	97.00
% to MWR	93%	99%	86%	68%	76%
MARINE CORPS					
Net Earning	23.0	21.9	19.4	17.6	18.1
Pymt to MWR	18.4	16.8	15.9	15.1	15.2
$ per capita	93.40*	147.00	115.00	90.00	97.00
% to MWR	80%*	77%	82%	86%	84%

* Includes MWR

MARINE CORPS

The Marine Corps MWR Policy Review Board acts as the corporate Board of Directors, is chaired by the Deputy Chief of Staff for Installations and is represented by three members from headquarters and three from field commands. Marine Corps Exchange and MWR operations are fully consolidated at the local and central level. Reinvestment and support to non revenue generators are accomplished by a combination of a three percent assessment on revenue generators, of which 1.25 percent is for a construction fund, and a reserve account for non revenue generators which is described below.

Marine Corps profits are distributed at the end of each fiscal year. Profits available for distribution are those from all revenue generating activities (e.g., exchanges, golf courses, large bowling centers, food and beverage operations, unofficial travel offices, etc). Up to 30 percent of profits are distributed to the local capital account until this account meets the minimum capital requirement. A minimum of 70 percent of profits go to the reserve account for non revenue generators. The only ceiling to this reserve account is when after reaching $120 per capita, 50 percent of the excess is sent to Marine Corps headquarters to support small commands.

NAVY

The Navy's MWR Policy Board is chaired by the Chief of Naval Personnel with representation from staff and major commands, NAVRESSO and the senior enlisted military representative. Distributions are governed by a negotiated guarantee to the Navy MWR Central Fund. The current guarantee pays $36M annually for fiscal years 1990 through 1992. In addition, any amount over the $36M received from the "core" retail profits will be retained by NAVRESSO until the NAVRESSO reinvestment percentage reaches 40% of core profits, after which NMPC MWR and NAVRESSO split 60/40. Specific distribution procedures for pay phones, amusement machines, name brand fast food and class VI stores are outlined in Figure 3-10.

ARMY/AIR FORCE

AAFES Board of Directors is represented by staff and major command personnel and the senior military enlisted person from the Army and the Air Force. The Chairman of the Board alternates between the Principal Deputy Assistant Secretary of the Air Force, Financial Management (Resource Management) and the Comptroller, U.S. Army. The AAFES commander is also a member. The AAFES commander and vice commander positions alternate between the Army and the Air Force. The current basic dividend distribution policy is 50 percent to AAFES and 50 percent to MWR (excludes class VI stores, pay telephones, and category III food operations). AAFES also provides a "safety net" to facilitate MWR program planning. MWR is guaranteed the amount that is within 10

percent of their "plan". The profit distribution policy for class VI stores, pay telephones and category III food operations is described in notes 1,5 and 6 of Figure 3-10. Army and Air Force negotiate individual MOU's that direct certain profits either locally or to major commands as outlined in Figure 3-10.

FIGURE 3-10 PROFIT DISTRIBUTION AGREEMENT

BUSINESS	ARMY	AIR FORCE	NAVY	MARINES
Pay Phones	L(1)	L(1)	C(2)	•
Fast Food (name brand)	L(3)	C(3)	L(4)	•
Beverage Stores (Pkg store/soda)	L(5)	L(5)	L	•
Other Food/Bev (exchange run in MWR facilities)	L(6)	N/A	N/A	•
Amusement Machines	C(7)	L	L	•
Other Retail	C	C	C	•

L - Predominant or total distribution to Base MWR
C - Predominant or total distribution to Central MWR

Notes:

(1) 80% to local MWR fund, 20% to AAFES. The AAFES 20% then drops to the retail bottom line and is distributed 50/50 between AAFES and Army/Air Force

(2) $10.5M annual fixed guarantee to Navy Central Fund through FY 92. NAVRESSO retains remaining phone profits.

(3) Army - 50% fast food profits to local MWR Fund: Air Force - 50% to Central MWR Fund - 50% to AAFES capital program (not subject to regular dividend distribution)

(4) 25% to local MWR Fund - 25% to major command - 50% to NAVRESSO (becomes part of pool of money available for guarantee).

(5) Guarantee is the net income before depreciation in FY 88 (treated as an expense to AAFES, plus 50% to the FY 88 AAFES beer and wine net income (treated as a prepaid to central funds). Subsequent period adjustment upwards by a 4% inflation. This serves as interim agreement pending a more workable formulas. All net earnings above this level are split 50/50 between local MWR fund and AAFES capital program (not subject to regular dividend distribution).

(6) a. If AAFES operates the CAT III food facilities on the installation, the installation:

> (1) receives 50% of net earnings of all the CAT I facilities (to include Burger King) on the installation. AAFES receives the remaining 50% for their captial program, not subject to any further distribution.
>
> (2) receives 50% to 75% of the direct operating results (DOR), net earnings before overhead is applied, of all CAT III resale food operations on the installation. The remaining DOR of the CAT III food operations is treated as AAFES earnings and is distributed in accordance with normal AAFES distribution policy.

(b) If the installation operates the CAT III food facilities the installation receives 50% of Burger King profits. All other CAT I food profits become part of the regular dividend distribution.

(7) If AAFES operates, revenue is split 50/50 with local MWR fund. AAFES portion becomes part of regular dividend distribution.

• Marine Corps Exchange and MWR operations consolidated.

SECTION 3.5 FINANCIAL HEALTH ASSESSMENT

Each of the exchange systems were reviewed as to their financial health. The review consisted of three parts: (1) a review of the profitability and liquidity of the exchange systems using key financial ratios (2) an overall assesment of their financial health using the Altman bankruptcy model and, (3) review of the adequacy of reserves to accomodate potential liabilities of self insurance and employee benefit program.

Financial Ratios

The purpose of reviewing key financial ratios is to get a sense of the liquidity and profitability of each of the exchange systems. Is is not designed to show, in an absolute manner, that one system is better than the other. Differences in accounting procedures, financial reporting, and policies make an exact comparison inappropriate and uninformative. Following are examples of differences between the exchange systems:

- Navy exchanges assumed responsibility for Class VI on 1 October 1987 while AAFES did not assume Class VI until April 1989.
- Profits from pay telephone contracts are reflected in Navy's net income while only 20% of these profits are reflected in AAFES' net income.
- AAFES does not restrict use of its self-insurance sinking fund assets while the Navy and Marines do.
- Navy exchanges were the sole source for cigarettes and sodas on Navy installations while AAFES must compete with Army and Air Force commissaries on these products.

Figures 3-11 through 3-15 show key liquidity and profitability financial ratios for each of the exchange services and two industry averages. The industry averages from published studies prepared by Harris Bank and First Chicago Bank. The values from the Harris study represent companies they categorize as mass merchandisers. Companies included in the First Chicago study are classified as discounters. The AAFES and Navy data used in computing these ratios are primarily from AAFES annual reports and Navy independent auditors reports. The Marine Corps does not publish a corporate annual report nor have they had an independent auditor's report since FY 86. Thus, unaudited data are used for them. In addition, the merger of the Marine Corps exchange and MWR systems does not allow separate identification of exchange data for FY 89.

FIGURE 3-11 CURRENT RATIO

	FY 89	FY 88	FY 87
AAFES	2.16	2.25	2.19
NAVY	1.88	1.78	1.98
MARINES	N/A	3.16	2.61
HARRIS	N/A	2.03	2.21
1ST CHICAGO	N/A	1.92	1.80

FIGURE 3-12 QUICK RATIO

	FY 89	FY 88	FY 87
AAFES	.41	.37	.37
NAVY	.31	.40	.52
MARINES	N/A	N/A	N/A
HARRIS	N/A	1.10	1.18
1ST CHICAGO	N/A	.19	.16

FIGURE 3-13 CASH PROVIDED BY OPERATIONS/CURRENT LIABILITIES

	FY 89	FY 88	FY 87
AAFES	.44	.50	.27
NAVY	.59	.50	.43
MARINES	N/A	N/A	N/A
HARRIS	N/A	N/A	N/A
1ST CHICAGO	N/A	N/A	N/A

FIGURE 3-14 RETURN ON SALES

	FY 89	FY 88	FY 87
AAFES	4.9%	3.5%	4.4%
NAVY	5.0%	4.7%	4.4%
MARINES	N/A	4.8%	4.6%
HARRIS	N/A	3.3%	3.3%
1ST CHICAGO	N/A	3.6%	3.7%

FIGURE 3-15 RETURN ON ASSETS

	FY 89	FY 88	FY 87
AAFES	12.2%	8.8%	11.1%
NAVY	16.3%	14.7%	13.3%
MARINES	N/A	14.2%	15.2%
HARRIS	N/A	5.6%	5.5%
1ST CHICAGO	N/A	4.5%	6.0%

The liquidity of the three exchange systems is adequate. Their current ratios are in line with the industry numbers. Industry quick ratios are quite divergent. However, AAFES and Navy quick ratios fall in between the two industry figures. Profitability of the exchange systems is also good. Each exchange system's return is better than the industry average as reflected in return on sales and return on assets ratios.

Altman Bankruptcy Model

Edward I. Altman has developed a model for measuring the likelihood of bankruptcy for an organization. The model is widely used in the banking industry to assess the overall financial performance of a company.

The model is:

$$Z = 6.56\ X1 + 3.26\ X2 + 6.72\ X3 + 1.05\ X4$$

where:

X1 = working capital/total assets

X2 = retained earnings/total assets

X3 = earnings before interest and taxes/total assets

X4 = net worth/total liabilities

Model results are interpreted as:

$Z > 2.60$,	Bankruptcy unlikely
$1.10 < Z < 2.60$,	Bankruptcy uncertain
$Z < 1.10$,	Bankruptcy likely

Figure 3-16 shows the Z scores for AAFES and Navy. As reflected in these Z scores, the overall financial performance of both exchange systems is very good. Both

organizations are consistently well above the bankruptcy cutoff value.

FIGURE 3-16 ALTMAN Z SCORES

	FY 89	FY 88	FY 87
AAFES	7.47	7.50	7.42
NAVY	6.91	6.55	6.97

Self Insurance and Employee Benefit Program Funding

The self-insurance and employee benefit programs were reviewed for adequacy of reserves (cash and other assets) to accommodate potential (future) liabilities of these programs.

Assets and General Liability Insurance

AAFES AAFES is self-insured for asset and general liability insurance. The liability is actuarially determined and a sinking fund is maintained to support the level determined. Sinking fund assets are available for (not restricted from) use in general operations. Currently, AAFES is maintaining a sinking fund equal to 89% of its actuarially determined liability. In addition, AAFES has borrowed from this sinking fund (vice commercial sources) for use in general operations, and the sinking fund effectively has a zero balance, i.e., no funds are available in the sinking fund for claims payments. However, AAFES' ability to pay claims is not in jeopardy since it has an extensive capacity to borrow from commercial sources.

Navy Navy uses a combination of commercial insurance and self-insurance to meet its asset and general liability insurance needs. Generally, it carries commercial catastrophic insurance and is self-insured for the remaining of its requirements. The self-insured liability is actuarially determined and a sinking fund is maintained equal to that amount. The sinking fund assets are restricted from other uses, and the Navy currently has sinking fund assets equal to the actuarially determined liability.

Marine Corps Marine Corps also uses a combination of commercial and self-insurance for its asset and general liability insurance needs. Like the Navy, it carries commercial insurance for catastrophic occurrences. It's self-insurance is through an in-house "Insurance Co." (a separate nonappropriated fund instrumentality) to which premiums are paid by the other nonappropriated fund instrumentalities (NAFIs). The premiums are based on an

in-house estimate of a NAFI's exposure. Since the self-insurance is through a separate NAFI, the assets are restricted from use in general operations. The insurance NAFI's funded reserves equal approximately 46% of the estimated requirement. Alexander and Alexander Consulting Group is currently undertaking an actuarial review of the Marine's self-insurance program. Expected completed date is November 15, 1990.

Workers' Compensation Program

The Navy and Marine Corps use a combination of commercial and self-insurance to cover their workers' compensation liability. AAFES is totally self-insured for this program. All three exchange services maintain restricted-use sinking funds to cover their self-insurance liability for this program and have certificates of deposit with the Department of Labor (DOL) to cover the liability. At the current time, Navy is borrowing against their reserve by using surety bonds. AAFES and Marine Corps use DOL's actuarial estimate of their liability to determine their sinking fund level. Navy uses an actuarial estimate prepared by Nationwide Insurance.

Group Medical Insurance Program

Navy and AAFES are totally self-insured for this program. Claims are paid from current year cash flows. At the end of the fiscal year, both Navy and AAFES accrue a liability for estimated future claims.

Marine Corps has commercial insurance for catastrophic loss and is self insured for the remainder. Claims are paid from current-year earnings. There is no accrual of a liability at the end of the fiscal year. However, they apportion equity in an amount to cover estimated future payments.

Foreign National Severance Liability

Each of the exchange services are accruing a foreign national severance liability. However, the exchange services have set aside differing amounts of assets to cover this liability. DODI 7000.12, para. g states that funds should be set aside to cover this liability. As a minimum, the amount set aside on a component-wide basis must be sufficient to defray all severance payments likely to become due at any point in time, without recourse to other NAF assets within the DOD component.

AAFES AAFES accrues a foreign national severance pay liability based on 50% of an actuarial estimate of the liability. They maintain a sinking fund equal to the liability but those assets may be used in general operations. Hence, the value of the assets actually available to support this liability varies. As of the end of FY 89, the value of the assets in the sinking fund approximated the sinking fund. Unlike the other exchange organizations, AAFES does accrue a liability and maintains a sinking fund for

foreign national severance pay for Japan and Okinawa. The other exchange systems rely on guarantees that the government of Japan (GOJ) will reimburse for any severance payments as long as there are GOJ funds available.

Marine Corps Marine Corps' only foreign national severance liability is at Guantanamo Bay and in Japan. They are relying on the GOJ to reimburse for any Japanese severance payments and thus, have established a long-term receivable equal to the accrued liability. No assets have specifically been set aside to cover this liability. The Marine Corps has accrued a liability for their Guantanamo operations and set aside (restricted use) funds equal to the liability.

Navy Navy has fully accrued its liability based on current requirements and maintains a restricted-use sinking fund in an amount equal to the liability. The Navy has no unrecognized nor unfunded liability. The Navy would like to have permission to invest in foreign country (or central bank) backed/guaranteed bonds. The exchange services have a long-term foreign currency exposure on the liability side, and the ability to invest in foreign-country bonds would balance that foreign-currency exposure.

Pension Funds

Both AAFES and Navy pension plan disclosures are made in accordance with FAS 87 and FAS 88. Both pension plans are fully funded. The pension plan liabilities are determined by an independent actuarial. As of December 31, 1989, the market value of the Navy's pension plan's assets were nearly 150% of the plan's projected benefit liability and had a prepaid pension cost equal to .2% of the plan's projected liability. Likewise, the market value of the AAFES pension plan's assets were 115% of the plan's projected benefit obligations with a prepaid pension cost equal to .7% of the plan's projected liability.

Unlike the other two exchange services, the Marine Corps does not follow FAS 87 disclosure rules. However, they do have an independent actuarial estimate of their projected benefit liability. The Marine Corps pension plan is not fully funded to cover its projected benefit obligation. The market value of the plan's assets equal 93% of the plans projected benefit obligations. However, the plan's assets are sufficient to fully fund to present benefits.

Conclusion

The current exchange systems are in good financial health. Their overall financial performance as measured by the Altman model is very strong. In addition, their profitability and liquidity are in-line with or exceed the industry's average.

Nor are there any significant problems associated with the funding of the self-insurance and employee benefit programs of the three exchange systems. Different exchange system policies lead to different funding levels for these programs, but none of the

policies should result in significant unfunded requirements. For example, AAFES has borrowed from its self-insurance sinking fund to support its general operations instead of borrowing from commercial sources. However, this does not place AAFES in jeopardy of not being able to pay claims since it has extensive commercial borrowing capacity upon which to draw. On the other hand, Navy borrows internally from its workers' compensation fund through the use of surety bonds.

There are two areas that should be noted. First, in the near future AAFES will most likely be facing significant levels of foreign national severance payments in Europe and possibly in the Pacific, e.g., the Philippines. AAFES needs to take action now to insure that its severance pay sinking fund has sufficient assets to cover these payments. Second, an exact comparison of the Marine Corps pension plan funding with AAFES' or Navy's is not possible since the Marine Corps does not follow FAS 87 disclosure rules. The impact on the Marine Corps finances of adopting FAS 87 is unclear but could result in increased expenses.

Finally, it appears that it would be beneficial to allow the exchange systems to invest in foreign country (or central bank) backed/guaranteed bonds. This allows them to cover their foreign national severance liability exposure with foreign country investments and thereby mitigate the impact of foreign currency fluctuations and inflation.

SECTION 3.6
STAFFING METHODOLOGY FOR CONSOLIDATED ACCOUNTING

To analyze the potential savings associated with consolidation a detailed study of the accounting function was made. Since the financial management systems of each exchange were considered adequate and the major accounting functions being performed were the same, staffing requirements of a consolidated exchange were developed based on a productivity computation of dollars of direct sales per accountant.

Each of the exchange systems were asked to provide the number of accountants above the selling floor level by location. An overall system productivity figure was then computed with preliminary figures as follows:

FIGURE 3-17 ACCOUNTING PRODUCTIVITY FIGURES

	Sales	Acct'nts	Productivity
MC	$520,694,853	263	$1.9M
AAFES	6,102,083,886	1,363	4.4M
Navy	1,743,347,287	613	2.8M

Staffing for each exchange was subsequently adjusted to reflect any minor differences in functions and a productivity standard of $4 million per accountant was used to determine the number of additional accountants that would be required in a consolidated exchange. The additional 566 people (total direct Navy and Marine Corps sales divided by $4 million) were costed at $17,450 and rounded upward to $10 million. The offsets in current operating costs were achieved by eliminating the Navy Field Support Offices, NAVRESSO Headquarters and those Marine Corps accountants not required for MWR accounting. Therefore, consolidated accounting could be expected to achieve $5.9 million in annual savings.

SECTION 3.7
ALTERNATIVE ORGANIZATION STRUCTURES

The study group considered several alternative methods to increase efficiencies and reduce overhead costs so as to achieve savings in both nonappropriated and appropriated funds. Among those considered were: establishment of a government sponsored enterprise; transferring operational responsibility to the dominant exchange system within a given geographic region; developing cooperative ventures and sharing support services; maintaining separate exchange systems, establishing a central support structure with separate operational structures for each Service and; implementing a total consolidation. The first two options failed to provide significant reductions to overhead expenses and were ultimately considered to be additional scenarios under the separate exchange system alternative.

What follows are descriptions of a government sponsored enterprise and the three alternatives considered.

GOVERNMENT SPONSORED ENTERPRISE

The study group was asked to invesitigate a possible organizational structure for a consolidated exchange system known as a government-sponsored enterprise (GSE). In general, GSEs are entities organized in corporate form, established by Acts of Congress, and share a close relationship to the U.S. Government. Some of the organizations that are considered GSEs include Amtrak, Federal Deposit Insurance Corporation (FDIC), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal National Mortgage Association (Fannie Mae), Tennessee Valley Authority (TVA), and United States Postal Service (USPS). GSEs obtain there financing through the issuance of debt, fees charged for services provided or products sold, and federal appropriations.

GSE characteristics vary widely from organization to organization and depend upon the authority granted them by the legislation creating their

organization. Some of the entities are completely owned by the federal government (e.g., TVA) while others are not (e.g., Amtrak). Some receive appropriated fund support while others do not. Most GSE activities are not counted as part of the federal budget, however, there are a few GSEs such as the TVA which are included as part of the federal budget.

The ability to issue debt is not automatically a characteristic of a GSE. A GSE may issue debt only under the authority granted it by an Act of Congress. For example, the legislation establishing the TVA did not authorize the TVA to sell bonds to finance power plant construction. Instead, TVA had to appeal to Congress for construction funds. It wasn't until 1959 (26 years after the TVA's creation) that Congress amended the legislation to allow the TVA to sell bonds. However, it also required the agency to repay with interest the money Congress had appropriated for construction before 1959. Additionally, legislation creating GSEs provide different levels of explicit U.S. Government support. Some debt is considered to have the full faith and credit of the U.S. Government while other does not. Finally, some enterprises (e.g., TVA) may issue debt only with the approval of the U.S. Treasury while others (e.g., USPS) have no such restriction.

At the current time, there appears to be no advantage in converting the exchange operation from a nonappropriated fund instrumentality (NAFI) to a government-sponsored enterprise. The current operational authority given the exchange systems is very similar to some GSEs. The exchanges are already organized and operated in a manner similar to a private business enterprise. They obtain the vast majority of their revenues through sales to customers. As is true with many GSEs, the exchanges also receive some limited appropriated fund support.

Although the exchanges do not have the authority to issue bonds, they do have the authority to borrow funds for both their operational and capital requirements. Furthermore, AAFES has a legal opinion that its debt has the backing of the full faith and credit of the U.S. Government. Finally, converting from a NAFI to a GSE may lessen the recognition that the exchange systems are a military benefit and, in a sense, cooperatives dedicated to serving their customers which are also their "owners".

SEPARATE EXCHANGE SYSTEMS (STATUS QUO)

Each of the three exchanges are pursuing numerous actions to gain operating efficiencies, reduce costs and address the environmental changes which will result from projected base closures, troop draw downs and the loss exclusive sales rights for cigarette sales and soft drinks. The impact of these environmental changes differ among the three exchange systems and each has devised independent strategies to

offset these impacts.

The study group accepted the planned actions of each of the exchange systems and the projected savings as being valid. No distinction was made between on-going projects or those in their preliminary stages and all were assumed to be implemented. One-time implementation costs are excluded from the analysis. All projected savings and revenue losses are added to 1989 operating results for comparative and analytical purposes.

AAFES AAFES has several projects under development and in various phases of implementation which will significantly reduce future overhead costs. Most of these projects are independent of base closure and troop draw down/re-deployment actions. However, the magnitude of the European headquarters drawdown is predicated upon significant draw down of troops stationed in Europe. Not included in any of these cost saving initiatives are any reductions to the AAFES distribution system which would result from any troop draw down of the magnitude projected nor any reduction in the Headquarters or Operations Support Center which would similarly result from major sales losses.
The AAFES initiatives used to project future cost reductions are as follows:

- Fresh Start. An on-going project which closes out the previous four CONUS exchange regions and establishes an Operation Support Center in Dallas, TX and creates four Directors of CONUS Operations to manage the operational aspects of four CONUS geographic areas.

$15.6 million

- European Area Exchange Realignment. A project currently being implemented which realigns European Area Exchanges to the CONUS organization.

$2.7 million

- European Headquarters Realignment and Drawdown. A multi-phased project, the first of which is currently being implemented at a $2 million cost reduction, which realigns the European Headquarters to take advantage of telecommunication capabilities, revised management concepts and draw down of troops stationed in Europe.

$18.9 million

- AAFES Store Automation Project (ASAP). An automation project under development which will automate store operations and eliminate numerous positions involved in manual data preparation, etc.

$19.8 million

- Satellite Telecommunication. An on-going project to convert CONUS from land line telecommunication to a satellite network. The new network will be used for both data and video transmission and the savings represent only the difference in line vs satellite costs.

$2.0 million

- Elimination of Consultant Services. The implementation of ASAP and Interactive General Ledger Accounting System (IGLAS) will conclude the developmental contract with Coopers and Lybrand consulting services.

$3.9 million

- Reduction in Systems Project Development Requirements. The implementation of ASAP and IGLAS will reduce the requirement for functional analysts.

$2.3 million

<u>NAVY</u> The Navy Exchange system has several projects in the developmental and implementation phases which are expected to significantly reduce the overhead costs currently incurred. These projects are independent of any troop reduction or base closure actions and can be expected to be implemented in a separate exchanges system scenario.

- Consolidation of Field Support Offices. The Navy Exchange system has developed a multi-phased program to consolidate the present seven CONUS FSOs into three. The first phase of the program, consolidation of the northeastern United States with a projected savings of $3.6 million, has already been approved and is underway.

$7.6 million

- Decentralization of Accounting Functions. The Navy Exchange system is currently decentralizing various accounting functions and will achieve significant staffing reductions at the NAVRESSO headquarters.

$1.0 million

- Case Management/Hospital Bill Audit Program. The Navy Exchange has recently implemented a program to better manage health benefit cases and anticipates significant cost reductions to their contribution.

$0.5 million

- Computerized Store Labor Scheduling. Current operations to implement automated labor scheduling techniques in Navy Exchanges is anticipated to achieve savings in operating costs.

$0.5 million

- Reduction in MIS Cost. The proposed upgrade of the Navy MIS system is expected to reduce equipment costs.

$0.6 million

MARINE CORPS The Marine Corps exchange and MWR consolidation was just completed in 1989 and the majority of cost savings are only now beginning to be realized. These savings can be attributed to both the exchange and the MWR activities.

- Marine Corps and MWR Consolidation. The Marine Corps estimates that the consolidation of the Marine Corps exchange and MWR will generate an additional 5 percent savings on the bottom line.

$1.2 million

- Reduction in MIS Costs. The Marine Corps MIS modernization program is projected to reduce annual MIS equipment costs.

$2.3 million

The impact of the separate exchange systems (status quo) initiatives are reflected in the proforma net earnings analysis included in the conclusions of this chapter.

CENTRAL SUPPORT FOR SEPARATE SYSTEMS

One of the alternatives investigated by the study group was the use of the AAFES infrastructure to provide total purchasing, distribution, accounting, construction and MIS support to the Navy and Marine Corps exchanges. Under this scenario, each exchange system would maintain operational control over all functions dealing directly with the customer, determine their own method of profit distribution and maintain their current command and control relationship.

While this alternative made any consolidation transparent to the customer and to a great degree to Command and the Services' MWR elements, it would dramatically curtail the alternatives available to the Navy and Marine Corps exchanges in controlling costs and the generation of earnings. It also placed the Navy and Marine Corps exchanges in the position of having to absorb all personnel reductions and costs. Finally, this alternative generated approximately $15 million less in savings than total consolidation.

While this alternative failed to maximize savings, it did provide substantial savings over current costs while maintaining many of the Service prerogatives. However, when reviewed by all Services, they concurred with the study group that the shortcomings of the alternative outweighed the returns.

CONSOLIDATION

Under the consolidation alternative, the three separate exchange systems would be merged into a new organization. The Navy Lodge Program and the Uniform Program are also excluded as they would be transferred internally within Navy. The consolidation would, however, require a dismantling of the recent merger of the Marine Corps exchange system and their MWR program.

Figure 3-18 summarizes the annual recurring costs and

benefits expected upon full implementation of the consolidation.

A consolidated exchange system is projected to have annual savings of $44.2 million more than if separate systems are maintained (status quo).

In addition, there are initiatives planned under the status quo that will generate $9.1 million in savings that will also be pursued under consolidation. Thus, the total impact of consolidation in comparison to FY 89 earnings is an increase of $53.3 million.

Figure 3-18 ANNUAL RECURRING COSTS AND BENEFITS

Effected Function/Location	Total Consolidation ($ in 000's) Savings Cost Avoidance New Income ($)	Additional Costs (*)	Reference
Marine Corps Buyers at Store Level	6,215		Chapter 4
Marine Corps Accountants	2,295		Sec 3.6
Marine Corps Headquarters	1,010		Sec 3.7
NAVRESSO Headquarters	27,322		Sec 3.7
Navy FSOs	42,945		Sec 3.7
Navy Independent Exchanges	2,495		Sec 3.7
Navy/Marine Corps Store Staffing		13,300	Table 7-4
Augmentation of Navy/ Marine Corps Buyers		9,800	Table 4-11
Augmentation of Navy/ Marine Corps Accountants		10,000	Sec 3.6
Augmentation of Navy/ Marine Corps Distribution	34,000	24,300	Fig 5-7
Augmentation of DCO Organization		770	Sec 3.7
Augmentation of Area Exchange Structure		8,812	Sec 3.7
Augmentation of Headquarters		4,367	Sec 3.7
Headquarters Expense Additions		6,401	Sec 3.7
AAFES MIS Savings to Current Navy/Marine Corps Systems	7,309		Chapter 6
Food Services "Savings"	300		Chapter 8

Personal Services "Savings"	313		Fig 9-9
Impact of EMP Program for Navy/Marine Corps		550	Page 12-8
Impact of In-House "Construction"	921		Chapter 10
Interest Cost for Lower Inventory Turns	______	3,122	Table 4-12
Totals	125,125	81,422	
"Net" Benefit	43,703		
Navy initatives under Separate Systems (Status Quo)	(9,100)		Sec 3.7
Navy & Marine Corps Store Reductions resulting from AAFES Store Automation Program (ASAP)	9,600		Chapter 6
"Net" Consolidation impact	44,200		

(*) Cost/Benefit stated in relation to FY 89 operations

It is anticipated that a consolidated exchange system will build upon the AAFES structure since it is the largest system and has a worldwide, sophisticated infrastructure. Consequently, the additional cost and benefits associated with the new organization and reflected in Figure 3-18, are based on establishing an AAFES-like organizational structure by augmenting the AAFES staff structure while deleting the cost of the Marine Corps and Navy Exchange systems' staffing. This should not be interpreted to mean that the Marine Corps and Navy Exchange systems will be rolled into AAFES. It is merely the approach used to determine the appropriate staffing and cost of the new organization.

The savings shown in Figure 3-18 for Marine Corps headquarters, NAVRESSO headquarters and Navy Field Support Offices (FSOs) and Navy independent exchanges result from eliminating duplicative headquarters and other functions. The Marine Corps savings are based on figures provided by the Marine Corps as related to their headquarters staffing involved in exchange operations. The NAVRESSO headquarters, Navy FSOs and Navy independent exchange savings are based on 1989 operating costs adjusted for unique one-time costs supplied by NAVRESSO. These savings are partially offset by augmentation costs to be discussed in the following paragraph.

The various augmentation costs shown in Figure 3-18 reflect the additional staffing needed by the new organization to offset the eliminations discussed in the previous paragraph. The area exchange augmentation is based on adding eight area exchanges staffed with six people each (based on additional sales and adjusted for geographic clustering). Staffing augmentation (based on sales volume) for headquarters functions not individually addressed in the study, results in the addition of 86 new positions. An additional 12 operations specialists are added to support the directors of CONUS operations. Headquarters expense additions are computed using existing NAVRESSO miscellaneous headquarters expenses less special services.

In addition to annual recurring costs and benefits, there are one-time costs and benefits. The costs focus on one-time implementation costs associated with personnel realignment and conversion to the AAFES management information system (MIS). The benefits primarily relate to cost avoidance resulting from the Navy and Marine Corps not incurring research, development and implementation costs for a new MIS.

Figure 3-19 summarizes the one time costs and benefits associated with a consolidate exchange system. The net one time cash impact or cash outflow is $6.0 million. However, the impact on profits is greater ($8.1 million cost). There are two reasons for this difference: (1) the annual leave payout required for terminated employees has a cash

outflow impact but no profit impact since this expense is accrued and, (2) the write off of fixed assets reduces profit but has no impact on cash outflow.

Figure 3-19 ONE-TIME COST/BENEFIT

FIGURE 3-19
ONE-TIME COST/BENEFIT
Total Consolidation
($ in 000's)

	Costs	Benefits	Reference
Personnel Relocation	8,400		Sec 3.7
Severance Pay	2,900		Sec 3.7
Unemployment Compensation	4,900		Sec 3.7
Additional Office Equipment	417		Sec 3.7
Food Concept Development		1,800	Chapter 8
Training-Personnel Costs	7,851		Sec 3.7
-Travel Costs	5,368		Sec 3.7
Transfer of Distribution	7,100		Fig 5-5
	------	------	
Total(excluding MIS)	36,936	1,800	
	------	------	
MIS			

Navy Conversion Costs	30,285		Appendix C
Navy Cost Avoidance		55,600	Appendix C
Marine Corps Conversion Costs	7,586		Appendix C
Marine Corps Cost Avoidance		4,500	Appendix C
	------	------	
MIS Totals	37,871	60,100	
	------	------	
"Net" Cost--Profit Impact	12,907		
Annual Leave Payout(no profit impact)	2,610		Sec 3.7
Write-off of Fixed Assets(included in distribution amount above)		4,709	Fig 5-5
	------	------	
"Net" Cost-Cash Impact	10,808		
	======		

All of these one-time costs and benefits (figure 3-19) do not occur in the first year of consolidation. The personnel realignment costs discussed below will be mostly incurred in the first year of consolidation. However, the MIS conversion costs and cost avoidance will be spread over a three to five year period. The additional cost of acquiring a larger than proposed Southern California Distribution Center may be as much as $8.9 million which would be depreciated over a 20 year period.

The major one-time personnel costs identified were permanent change of station (PCS), out-placement assistance, severance pay, and unemployment compensation. Locating headquarters at an existing site saves real estate fees and also personnel costs.

PERSONNEL COSTS	
PCS COSTS DUE TO RELOCATION (avg. cost per move $24k X 350 = $8,400k)	$8,400,000.00
SEVERANCE PAY FOR 2048 EMPLOYEES (avg. 4-weeks severance $1,400 X 2048 = $2.867k)	$2,900,000.00
UNEMPLOYMENT COMPENSATION COSTS FOR 2048 EMPLOYEES RIF'D (avg. claim $2,400 X 2048 = $4.915k)	$4,900,000.00
TOTAL ONE-TIME PERSONNEL RELATED COSTS	$16,200,000.00

The modeling used to reach the one-time costs made the following assumptions. The new organization would require staff augmentation of approximately 300 new UA and 300 new HPP positions. Additionally, it is estimated that approximately 50 UA AAFES employees would leave if an "early out" retirement is offered in conjunction with a consolidation. This totals 650 new positions required.

The Study Group highly recommends consideration be given to offering an "early out" retirement option to lessen the impact of the consolidation. The "early out" options vary among the services as does their opinion as to its value. Marine Corps is extremely interested and plans to pursue that end. Navy Resale, while interested, plans to further investigate the option. AAFES fears the potential loss of a large number of the executive and managerial talent and therefore is less interested. Cost figures cannot be provided in as much as each of the three systems' retirement plans and philosophies are different.

Approximately 1,242 identified UA positions would be affected by consolidation. Assuming that 350 UA employees of Navy Resale and Marine Corps would relocate to accept positions in the new organization, it is estimated that 10% or 35 of these UA employees are renters and the remaining 90% or 315 are homeowners. Costs of these relocations were estimated at $13,600 per renter and $25,300 per homeowner. The average PCS cost is then computed at $24,000 for a total of $8,400,000. Based on previous Navy Resale and Marine Corps experience a conservative estimate of 20% of eligible employees or 249 were projected to take an "early out" retirement if offered.

The remaining 643 UA employees would be subject to reduction-in-force (RIF). Since the only commonality in the three systems' RIF policy and procedures is the offering of 4-weeks severance pay, that figure was used for computation purposes. The cost of 4-weeks severance pay for 643 UA employees is estimated at $1,465,250.37. The representative rate (step 4) of

the UA salaries was used against the UA grade distribution in AAFES system-wide (e.g., X UA-14's, X UA-13's, etc.).

An additional cost to be considered here is workers' unemployment compensation. The average estimate used for the three systems was the AAFES system-wide experience at $2,000-$2,400 per claim or $1,532,200.00 for 643 employees.

Approximately 1,994 identified HPP positions would be affected by consolidation. It is assumed, based on experience of present systems, none of the HPP employees of Navy Resale and Marine Corps

would relocate to accept positions in the new organization although the new organization would pay the relocation costs.

It is estimated that 211 HPP's in Marine Corps buying and accounting support positions and 1 HPP at the MWRSPTACT could be absorbed at their respective activity exchange or MWR operation. NAVRESSO stated that most likely none of the 365 HPP's at their headquarters nor the 1040 HPP's at their FSOs would be absorbed, however, the potential for placement of the 377 independent exchange employees appeared good.

1,405 HPP employees would be subject to reduction-in-force (RIF). Again, the 4-weeks severance pay figure was used for computation purposes.

An HPP composite salary was used in this estimate because of the numbers of wage areas paying differing hourly rates. The salary amount was then factored into the Navy Resale system-wide HPP grade distribution. The cost of 4-weeks severance pay for 1,405 HPP employees is estimated at $1,396,197.58 and unemployment at $3,372,400.00.

Training costs were based on providing approximately 300 man days of instruction at each 126 installations throughout the world with UA-12 instructors in travel status. In addition, 400 senior operating managers would be brought to Dallas area for one week of intensive management training. Total costs are estimated to be $7.8 million in salary and fringe and $5.4 million in travel expenses.

Finally, there is a cash flow impact, but no profit impact, due to accrued annual leave pay off occurring with a reduction in force. The estimate of $2.6 million shown in Figure 3-19 is based on 643 UA employees at 213 hours per employee and 1,405 HPP positions at 76.8 hours per employee.

SECTION 3.8
ANALYSIS OF OPERATING RESULTS AND CONCLUSIONS

The ultimate measure of the desirability of maintaining separate exchange systems or consolidation, rests in the ability to maintain or improve upon the present level of customer service and on the level of earnings available for distribution to the Service MWR programs and for capital investment in the exchange systems. Nothing has surfaced during this study which would support belief that any deterioration of customer service should be expected, and although elements other than the study group have projected significant sales losses, a stronger position could be made for significant sales growth based on historical performance. The study group generally accepts that customer service should not deteriorate, but rather by building upon the strengths that each system brings to the consolidation, should improve.

The impact on earnings available for distribution to MWR and investment in exchange capital programs must compare that which would be available under the separate exchange system (status quo) scenario and under consolidation, and must take into account all reasonably defined conditions.

Following is the study group's projections of the impact of definable actions on earnings available for distribution to MWR and capital programs.

PRO-FORMA NET EARNINGS

Previous cost estimates related to consolidation have focused on cost savings, cost avoidance, new income and any cost additions applicable to a consolidation. These assumptions are based on exchange operations as they existed in fiscal year 1989 versus net savings attributable to consolidation. This pro-forma analysis is intended to project the impact on net earnings of significant events such as troop reductions and the loss of cigarette and soda sales in Navy and Marine Corps exchanges. In addition, each exchange system has <u>planned</u> cost-saving initiatives designed to offset the negative impact on sales and corresponding earnings due to these significant changes. The pro-forma analysis in Figure 3-20 combines the two and reflects the impact if the systems remained separate and the impact if they are consolidated. Dollars are stated in constant fiscal year 1989 dollars, (i.e.,unadjusted for inflation).

Figure 3-20 PRO-FORMA NET EARNINGS ANALYSIS

PRO-FORMA NET EARNINGS
($ in millions)

FY 89 Net Earnings (as reported):			
AAFES	353.8		
NAVRESSO	95.1		
Marine Corps	23.0		
Total Net Earnings			471.9
Adjustments:			
Troop reductions:			
AAFES	(89.8)		
NAVRESSO	(4.0)		
Marine Corps	(2.9)		
Total troop reductions		(96.7)	
Cigarettes/Sodas:			
NAVRESSO	(6.9)		
Marine Corps	(2.0)		
Total cigarettes/sodas		(8.9)	
Current planned cost savings initiatives:			
AAFES	65.2		
NAVRESSO	10.2		
Marine Corps	3.5		
Total planned savings		78.9	
Total adjustments			(26.7)
Adjusted Net Earnings-Separate Systems			445.2
Total Consolidation Impact:			
Projected "net" savings	43.7		
Navy initiatives under Separate Systems (Status Quo)($7.6M FSO centralizations; $1.5M other Navy initiatives)	(9.1)		
Navy & Marine Corps Store Reductions resulting from AAFES Store Automation Program (ASAP)	9.6		
"Net" consolidation impact			44.2
Pro-forma Net Earnings-Consolidation			489.4

As can be seen, the impact of identified significant events on earnings potential and planned cost savings initiatives results in a reduction of exchange system net earnings from $471.9 million to $445.2 million, an unfavorable impact of $26.7 million. The "net" savings from consolidation is to increase net earnings by $44.2 million for a total of $489.4 million.

The overall favorable impact is $17.5 million or 3.7 percent when compared to FY 89 financial results and $44.2 million or 9.9 percent compared to the status quo (separate systems).

Figure 3-21 projects the impact of the proforma net earnings and subsequent distribution to MWR and funds retained for capital reinvestment.

Figure 3-21 PROFORMA NET EARNINGS DISTRIBUTION

FIGURE 3-21
PRO-FORMA NET EARNINGS DISTRIBUTION
($ in millions, except per capita)

	FY 89 (as reported)	Separate Systems Adjusted	Consolidated Pro-Forma
Total Armed Forces			
Earnings retained	149.5	139.6	190.9 (1)
$ per capita	63.59	85.38	116.73
AAFES			
Net Earnings	353.8	329.2	(1)
$ per capita	229.31	333.92	299.32
$ to MWR	216.0	201.0 (2)	180.0 (3)
$ per capita (4)	140.00	203.86	182.58
Navy			
Net Earnings	95.1	94.4	(1)
$ per capita	155.62	188.42	299.32
$ to MWR	88.0	87.4 (2)	91.5 (3)
$ per capita (4)	144.00	174.36	182.58
Marine Corps			
Net Earnings	23.0	21.5	(1)
$ per capita	116.75 (5)	145.53 (5)	299.32
$ to MWR	18.4	17.2 (2)	27.0 (3)
$ per capita (4)	93.40 (5)	116.43 (5)	182.58

NOTES:
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(1) Total consolidated pro-forma net earnings is projected to be $489.4, of which $298.5 or 61.0% would be distributed to MWR as reflected. The remaining $190.9 or 39.0% would be allocated to the Services' capital on a "need" basis. This profit distribution assumes same as FY 89 AAFES distribution %'s.

(2) Assumes same distribution percentage as FY 89 (computed FY 89 as a percent to net earnings).

(3) Assumes 61%/39% profit distribution(FY 89 AAFES distribution %'s)--"Consolidated Pro-Forma" for net earnings to be distributed.

(4) The troop strengths utilized were included in Secretary Cheney's 19 June 1990 News Briefing.

(5) If 50% of Support costs (attributable to support of MWR) are added back to net earnings, Marine Corps net earnings "$ per capita" would be $167.00 and $213.00, respectively and the "$ per capita" to MWR would be $144.00 and $183.00, respectively.

In fiscal year 1989, the net earnings retained for capital reinvestment in the military exchange system totalled $149.5 million or $63.59 per capita. Under the scenarios of separate systems (status quo), reflecting the significant planned events over the next five years, the system net earnings retained is projected to be $139.6 million or $85.38 per capita based on each exchange system's FY 89 dividend payout ratio. While total earnings decline, the decline in troop strength results in a per capita support increase. In the consolidated scenario, the military exchange system net earnings retained is projected to be $190.9 million or $116.73 per capita. This results from the $34.6 million increase in net earnings attributed to consolidation and $9.6 million from Navy and Marine Corps implementation of the AAFES Store Automation Program (ASAP), as well as an assumed increase in the combined percentage retained for capital needs to 39 percent of net earnings (the AAFES FY 89 percentage) from the 31.3 percent under separate systems. Thus, under each scenario presented, the per capita dollars retained for capital needs increases.

The second phase of this analysis is to project the impact on earnings distribution to MWR. As illustrated in Figure 3-21 the per capita dollars to MWR under separate systems are anticipated to increase for each of the Services.

Under consolidation, there is a decline for Army/Air Force and a slight increase for Navy when compared to the separate system scenario. There is a slight decline for the Marine Corps when adjusted for the support costs attributable to MWR under their consolidated organization (see note 5 to Figure 3-21). These results reflect increased net earnings due to consolidation partially offset by the increased distribution to capital (assumed a 39 percent profit retention versus 31 percent under separate systems). The unfavorable Army/Air Force impact is because they contributed 75 percent of the consolidated net earnings, but they receive only 60 percent of the MWR profit distribution (based on their percentage of troop strength and current AAFES profit distribution formula). Conversely, the Marine Corps contributes only 5 percent of net earnings but would receive 9 percent of the MWR profit distribution (based on their percentage of troop strength and AAFES profit distribution formula.

It should be noted that a dividend payout to MWR of a little over 68 percent would result in a $203.53 per capita MWR distribution and thus negate the Army/Air Force loss in a consolidated versus separate system scenario. This would result in an overall active duty $95.79 per capita retained for capital needs, which is still higher for the combined Services than the fiscal year 1989 or the separate system scenarios.

CONCLUSION

The conclusion that must be drawn, from a financial perspective, is that in light of the unfavorable events facing the military exchange systems over the next five years, total consolidation provides a means to minimize the impact of these unfavorable events and keep the systems on a financial basis comparable to fiscal year 1989. A equitable resolution would be required to reconcile the disparity between earnings contributed by Army and Air Force customers and the per capita earnings distributed to their respective MWR programs.

SECTION 3.9 RECOMMENDATIONS

- That the Services consolidate the individual military exchange systems into a new joint Service exchange system to eliminate current duplication, improve operational efficiencies and achieve projected annual savings of approximately $35 million.

- That a board of directors representing all Services, and responsible to the Service Secretaries, be established to govern the consolidated exchange system and to manage and control what is, in effect, the service members' money and quality of life vehicle.

- That the new board should develop a dividend policy that insures an equitable and balanced distribution of profits between capital investment and MWR support. Furthermore, initially, the dividend to each Service's MWR Program should consider the differences in the value of assets that each exchange system is contributing to the new organization.

- That the exchange system be permitted to invest in foreign country or central bank backed/guaranteed securities in order to cover its foreign national severance liability exposure with foreign country investments and thereby mitigate the impact of foreign currency fluctuation and inflation.

CHAPTER 4

PURCHASING AND INVENTORY MANAGEMENT

4.1 OVERVIEW

Within the commercial sector, inventory management is generally a sub-set of the overall buying function. Consequently, this chapter will explore the total buying function, to include the automated inventory control systems (inventory management), accomplished by the separate exchange systems, the Army and Air Force Exchange Service (AAFES), the Navy Resale and Services Support Office (NAVRESSO) and the Marine Corps Morale Welfare Recreation Support Activity (MWRSPTACT), in support of the dual mission of providing merchandise and services necessary for the health, comfort and convenience of authorized patrons and providing a supplemental source of funding for MWR programs.

The buying elements of the services' exchange systems have the same basic goals. Simply stated, the common goals are to provide:

- the right merchandise
- in the right quantities
- at the right price
- in the right place
- at the right time

These goal statements are deceptively simple; in reality, each statement encompasses a multitude of complex, interrelated functions, all of which are required for an effective and efficient buying system.

The purpose of this chapter is to review the exchange services' buying systems and to determine, using base line comparisons, if there are economies or efficiencies that could accrue by consolidation of the separate buying functions. This chapter is not a formal, detailed study of each buying

system, but, rather, is a general review of the strengths and weakness inherent in each type of buying organizational structure and an assessment of potential economies that may result from consolidation, given certain key assumptions.

This chapter reviews each of the military services' exchange buying organizations, outlines the advantages and disadvantages generally associated with each organizational structure and compares estimated buyer productivity, in terms of retail sales per buyer, of each exchange buying system. Key elements of each exchange service buying system are described and compared to identify similarities and differences among the systems. Since buying for customers located in the United States and overseas share common goals, the buying systems were considered in toto, although certain ratios normally associated with efficiency are lowered by the volume of sales overseas.

The exchange services provided specific information relative to buyer responsibility, staffing and wage costs. On two separate occasions representatives of each of the exchange services convened as an Purchasing (Inventory Management) Focus Group to provide background input, recommendations and concerns. On-site visits were made to selected buying locations for each service and detailed discussions were conducted with buyers at those locations.

4.2 EXISTING BUYING SYSTEMS

ORGANIZATIONAL STRUCTURE

The buying organizational structures of the exchange services range from completely decentralized, locally controlled offices (MWRSPTACT) through partially centralized and regionalized field support offices (NAVRESSO) to almost full centralization (AAFES). Within the Department of Navy, to include Marine Corps commands, the commander is responsible for operating exchanges in accordance with policies and procedures issued by the respective headquarters. Local Army and Air Force exchange operations are controlled by the Commander, AAFES, since AAFES is a major joint command of the Department of Army and the Department of the Air Force.

MWRSPTACT

The Marine Corps MWRSPTACT buying function is decentralized and is a part of the consolidated Morale, Welfare and Recreation Activities (MWR) at Marine Corps base level. Each command MWR activity is organized to include a retail division, consisting of a Head of Retail Operations and a merchandise staff. The local merchandise staff usually includes a merchandise manager, buyer(s), clerical personnel and a stock control section. Purchasing policy and procedure is the responsibility of the Retail/ Exchange Officer at local base level. Typical organizational alignment is shown at Figure 4-1.

NAVRESSO

The buying function for NAVRESSO is partially consolidated with buying functions at headquarters, NAVRESSO, eight Field Support Offices (FSOs),

reporting to NAVRESSO, and fourteen independent Navy Resale Activities (NRAs), reporting to installation commanders. The buying responsibility is divided between buyers and acquisitions (contracting specialist) personnel. Generally, the buyer is responsible for procurement of brand name merchandise and for fashion softlines; the acquisitions personnel are responsible for purchasing non-branded merchandise (solicitations) and for non-retail procurement. NAVRESSO maintains a buying office in Europe, under the control of the Contracts Group, headquarters, NAVRESSO. Purchasing policy and procedures is the responsibility of the Contracts Policy Branch, Contracts Group. Typical organizational alignment is shown at Figure 4-2.

AAFES

AAFES buying functions and responsibilities are centralized under the Purchasing Directorate (PD), located at headquarters, AAFES, Dallas, Texas. All purchasing functions, contracting and warehouse replenishment functions are performed in Dallas with the exception of the overseas' offshore procurement and selected local construction contracting. AAFES maintains a buying office in Japan for purchases from the Far East and has buyers in Europe that are part of the AAFES-Europe headquarters operations staff for purchases from the European markets. Contracting for local small construction projects (up to $10,000) in CONUS is accomplished at area exchange general manager level. AAFES purchasing policies and procedures are the responsibility of a separate Purchasing Policy Directorate (PZ). Organizational structure is shown at Figure 4-3.

BUYER RESPONSIBILITY AND AUTHORITY

Certain key functions determine the level of buyer responsibility and authority. Among these are:

- Determining a requirement exists for an item(s)

- Determining source of supply

- Determining resupply method (warehouse, vendor-to- store, etc)

- Determining order and reorder quantities

- Determining regular and special (promotional) sell prices

- Directing markdowns

- Establishing gross profit objectives, stock-to-sales ratios/inventory turn rates, in-stock levels

- Authority to commit (obligate) the organization (contracting officer authority)

Each of the exchange services report these functions to be the responsibility of the buyers and that buyers have the authority to execute these functions. Procedures exist for higher level management reviews and approvals for selected purchase actions and strategies, and coordination and concurrence from other operating elements may be required because of the impact buyer decisions may have on those elements. Discussions with buyers and explanation of procedures and processes suggests different definitions for these functions are used by each of the exchange

services. For example, negotiating and publishing a Price Agreement Bulletin (PAB) by a headquarters, NAVRESSO, buyer is not the same as a buy decision made by a MWRSPTACT buyer.

For the purpose of this chapter, the functional responsibility and authority of buyers is assumed to be equal among the exchange services. A full and detailed examination (which is beyond the scope of this review) of these functions is necessary since often responsibility may be shared with others or the authority so limited as to reside elsewhere on a de facto basis.

INVENTORY CONTROL (MANAGEMENT) SYSTEMS

Over the past several years, automated inventory control systems have been implemented and improved by the exchange services, with the goal of improving the effectiveness and efficiency of resources while improving customer service. The exchange services worked independently to achieve common objectives associated with automation.

In general, each exchange services' system is capable of some degree of electronic point of sale data capture, stock-keeping-unit tracking, store replenishment, purchase order generation, receiving, warehouse management and distribution, price change capability, transfer between facilities, generation of management reports, and physical inventory functions. Electronic Data Interchange (EDI) capability varies significantly.

The level of sophistication of the inventory control systems is directly proportional to the size of the exchange service. The MWRSPTACT system is least advanced, the NAVRESSO system more advanced and the AAFES system the most advanced.

MWRSPTACT

The MWRSPTACT Merchandise System is decentralized, which allows each MWRSPTACT exchange to operate as an individual retail entity, controlling its merchandise mix, inventory and accountability. All merchandise processing is accomplished at exchange level giving them control over and access to their databases. Point-of-sale scanning and EDI is not being used. The MWRSPTACT enjoys few of the benefits that accrue from centralized Management Information Systems (MIS) because of the level of technology supportable by the relatively small individual exchanges. Of significant note is the lack of standardized item and vendor databases, which from an inventory management point of view is key to maximizing use of systemwide resources. The MWRSPTACT reports that all hardware is obsolete and is no longer in production; maintenance costs are high.

NAVRESSO

The Automated Retail Merchandising System (ARMS) is an integrated merchandising, financial and distribution application software package. At headquarters, ARMS supports Fashion Distribution Center (FDC) purchase order entry, receiving and distribution, and maintains current Price Agreement Bulletins (PABs) for downloading to field ARMS sites. At FSOs, ARMS Merchandising modules provide purchase order management and

inventory control functions, including purchase order entry, pre- and post- distribution, merchandise transfer and retail price change capability, and stock replenishment for stores and warehouses. There is an interface with the POS system for capturing item movement data and maintaining the store level price-lookup (PLU) files. At store level, ARMS provides the capability to replenish stock using either a continuous review module, or a visual rapid reorder module on a hand-held computer. Although ARMS supports the operation of a centralized distribution center, it does not have the capacity or built-in functionality to support a high volume, high flow-through distribution center, nor does it support traffic, routing, employee productivity, bar-coded receiving/shipping, or automated material/merchandise handling.

NAVRESSO reports that ARMS merchandising applications were designed to support relatively low sales volume operations and that capacity has been reached for the large FSOs, although support of the small regions is satisfactory. Also, ARMS does not easily accommodate roll-up of management information to headquarters level. NAVRESSO reports that all hardware is antiquated, being operated at maximum capacity and is not upgradeable for either expanded processing or enhanced software operation. NAVRESSO now has eight EDI partnerships and plans to expand to 40 by year end. NAVRESSO does not have a standardized item or vendor data base.

AAFES

The Warehouse Inventory Control and Replenishment System (WICRS) is a combination of integrated data bases containing all merchandising data elements pertaining to items, facilities, vendors and warehouses. The AAFES system provides standardized item, vendor and facility data bases. WICRS provides primary data for merchandising applications systems, to include:

- Sales Promotion System
- Mail Order Catalog System
- Warehouse Locator System
- Warehouse Requirements System
- Warehouse Receiving System
- In-Line Processing
- Warehouse Management System
- Fashion Distribution System
- Open Order/Direct Delivery
- Branch Management System
- Exchange Region Receiving
- Retail Point of Sale

Information about data maintained by WICRS is available via on-line requests. Reports designed to fulfill specific needs are available by varying options and sequences, as required. AAFES reports that hardware and telecommunications are state of the art technology and positioned well for growth. There are no foreseeable constraints in either hardware or telecommunications. Resources are dedicated to updating application programs, to include major projects to eliminate store-level administration (AAFES Store Automation Program - ASAP) and a more viable general ledger system (Interactive General Ledger

Accounting System - IGLAS). AAFES utilizes point-of-sale scanning and data capture. Currently, AAFES has EDI partnerships with 89 major suppliers and is increasing resources dedicated to EDI in an effort to achieve 500 partnerships by the end of the year. AAFES is concentrating on those vendors supplying more than $500,000 per year. AAFES projects significant economies in inventory reduction, sales increases and personnel cost reductions from EDI efforts.

PRICING POLICY

Department of Defense exchange regulations (ASER 1330.9) specifies that merchandise and services sold should be priced in a substantially uniform manner at the lowest practicable level consistent with the primary mission of providing authorized patrons with articles and services necessary for health, comfort and convenience. The generation of supplemental funding for MWR is considered a secondary mission when establishing prices. Each Military Department prescribes the procedures for setting prices within its exchange service.

Only procedures regulating the establishment of retail prices were reviewed for the purposes of this chapter.

MWRSPTACT

The pricing strategy for the MWRSPTACT is based on the overall goal of saving the exchange customer about 20 percent over the prices of comparable goods in the surrounding community, without jeopardizing the financial integrity of the exchange. Policy sets the overall operating profit goal for each exchange as nine percent minimum. The DoD policy of pricing in a substantially uniform manner was deemed flexible enough to permit the continued decentralized system and to recognize varying geographical pricing differences. Individual exchange pricing polices are required to be coordinated with other Marine Corps commands in the same geographic area so that pricing practices at one command do not jeopardize the operational integrity of another command in close proximity. Essential items are priced with lower markups than are less essential items. Retail markon, expressed as a percent of sell price, is normally required to be not less than 15 percent and not more than 35 percent. Periodic price surveys of local competitors is required to identify items and categories requiring special attention. The use of broad class/subclass gross margin percentage pricing is discouraged. Higher markups are suggested for items demonstrating price inelasticity so that lower markups may be taken on items vulnerable to competitive pricing pressures.

NAVRESSO

The overall policy for setting sell prices is to provide average customer savings of at least 20 percent; this policy has not been formally published. Items of necessity have lower markups than discretionary or luxury items. An exchange stocking and pricing guide is published and provides the percentage markup for each merchandise classification authorized for sale in Navy exchanges. Headquarters, NAVRESSO, sets systemwide sell prices where common cost prices and terms are negotiated; these sell prices are published via PABs or Contract Bulletin (CB). Headquarters, NAVRESSO, sets sell

prices on all fashion and seasonal merchandise bought centrally and shipped through the Fashion Distribution Center (FDC). Sell prices on items included in one of the systemwide sales promotion bulletins (flyers) are established by NAVRESSO.

Using the markon percentages detailed in the stocking and pricing guide, FSOs and NRAs establish sell prices for merchandise procured locally and for items featured in locally developed sales promotion flyers. FSOs and NRAs are authorized to adjust sell prices to react to the local competitive environment. A Value Pricing Program was recently implemented (May 1990) for a select list of 205 items, which are frequently sold as loss leaders by local retailers. Local surveys are conducted and exchange sell prices are set equal to or lower than the lowest price surveyed.

<u>AAFES</u>

The retail pricing policy is based on providing an overall average savings of 20 percent below commercial prices. AAFES policy is to strive for worldwide uniform sell prices so items are sold at a common sell price worldwide. Local exchanges have the authority to meet local competitive sell prices and AAFES merchandising systems support installation peculiar sell prices.

Generally, markups are less on essential items and higher on luxury items. AAFES publishes a Retail Markup Manual, which contains procedures for the application of uniform markups and provides the flexibility needed to meet competitive prices. To a large degree, every day sell prices are established based on surveys of competitor sell prices and category earning objectives. In the early 1980's, AAFES implemented the Extra Value Program, which meets the competition's loss leader sell prices on about 370 select, high volume, image items. Sell prices are surveyed at commercial stores and prices set to meet the low price; prices are reviewed at least quarterly. Headquarter's buyers establish uniform, standard sell prices for all items; local exchanges monitor competitors and set local, non-standard prices, as necessary.

INDEPENDENT PRICE SURVEYS

Both NAVRESSO and AAFES use an independent, disinterested company, as discussed below, to conduct sell price surveys to verify the exchange services' goal of saving customers 20 percent is being achieved. The former Marine Corps Exchange Service last used an independent company for survey purposes in 1986. At that time, four locations were surveyed and the average savings were 23.1 percent.

<u>NAVRESSO</u>

Since 1983, NAVRESSO sell price surveys have been conducted by Ehrhart-Babic, an independent market research company. Prior to 1983, exchange price comparison surveys were conducted by exchange personnel. The purpose of the survey is to measure customer savings, determine actual competition, review pricing procedures and measure out-of-stock for survey items on the Master Stock Assortment. Approximately 300 items are selected by NAVRESSO buyers for inclusion in the survey. The items are representative of each merchandise department and are

considered by NAVRESSO to be representative of all items stocked by the exchange service. Surveys are conducted in eight locations, which have been repeated for the past four years. The locations are considered representative of the CONUS operation because of the demographic makeup, exchange size and competitive nature. The list of commercial stores to be surveyed at each location is developed by Ehrhart-Babic based on customer surveys. Up to three civilian prices are recorded for each item and savings are calculated based on average civilian prices. In 1989, the overall savings at the eight survey locations was 21.6 percent.

AAFES

Since 1978, AAFES has used the A. C. Nielsen, a nationally recognized company, to conduct sell price surveys annually in CONUS at 17 separate locations. Three hundred- seventeen items are included in the survey with five attempted commercial price comparisons for each item. Commercial stores shopped were initially identified by A. C. Nielsen through a survey of exchange patrons and the store list is revised annually to reflect the changing local market place. New items added to the survey list are selected jointly by AAFES and A. C. Nielsen; each new item added is selected by A. C. Nielsen from a list of 10 replacement items furnished by AAFES. State and local sales taxes are excluded from commercial prices. AAFES every day regular sell prices are compared with the commercial "prices of the day". The survey is not designed to be a market basket and does not represent savings expected from repetitive purchases of commonly used items. The survey is a valid indicator of customer savings comparing AAFES prices with average prices that exist in the competing, commercial market. In 1989, the overall savings at the 17 survey locations was 25 percent.

BUYER STAFFING AND PRODUCTIVITY

The exchange services reported authorized staffing for purchasing personnel and supporting clerical positions, including military personnel assigned procurement-related duties, and wage costs, including fringe benefits. The positions as reported by each of the exchange services are detailed in Table 4-1.

Productivity, in terms of dollar sales per buyer position and per clerical position, for the total positions reported are shown in Table 4-2. Sales volume used for computation includes gasoline sales and military clothing sales. Although within NAVRESSO and MWRSPTACT military personnel likely perform key buying functions, the military positions are excluded from buyer productivity calculations.

MWRSPTACT

Within the MWRSPTACT, there are a total of 134 salaried positions, 151 clerical positions and 14 military positions associated with purchasing-related duties at 18 separate exchanges and at headquarters. The reported annual wage cost, including fringe benefits and use of the average salary of buyers for military positions, is about $7.3 million. MWRSPTACT estimated that 13 salaried positions and 12 clerical

positions function in support of MWR activities other than exchanges, e. g., clubs, recreation centers, etc. These MWR-related positions are excluded from productivity calculations. Productivity totals $3.4 million per buyer and $2.9 million per clerical position.

During the meeting of the Inventory Management Focus Group, the MWRSPTACT representatives advised that MWRSPTACT exchange level buyers routinely perform non-buying functions in MWRSPTACT stores. These functions include providing product training to store personnel, maintaining store open- to-buy, directing store markdowns, maintaining store inventory levels and maintaining liaison with customers. The ratio of buying to non-buying functions could not be determined from data available. So, the ratios developed by the NAVRESSO representatives were used to adjust the number of MWRSPTACT positions. On an adjusted basis, there are 73 buyers and 111 clerks with productivity of about $5.6 million and $3.7 million, respectively, as shown in Table 4-3.

NAVRESSO

A total of 376 buyers, 525 clerks and 17 military personnel were reported as performing purchasing related duties at headquarters, FSO and NRA locations (Table 4-2). Productivity averages about $4 million per buyer and $2.9 million per clerical position. Total wages, including fringe benefits and use of the buyer average salary for military positions, was calculated based on NAVRESSO reported-data as about $27.7 million per year.

According to the NAVRESSO Focus Group representatives, the FSO and NRA buyers perform many non-buying functions at store level. Although the ratios of buying to non-buying functions could not be determined from data available, the NAVRESSO representatives estimated that adjustments equating to 40% of the number of buyers and contracting personnel and to 20% of the number of clerical personnel were necessary to factor out the non-buying functions. The adjusted figures total 268 buying and 410 clerical positions. Total wage costs were revised by NAVRESSO to about $16.4 million. Adjusted productivity is $5.6 million per buyer and $3.7 million per clerk, as shown in Table 4-3.

AAFES

Authorized AAFES staffing for buying and contracting totals 957 positions (military included) worldwide, excluding the authority delegated to area general managers for small construction contracts ($10,000 maximum). Of the total positions, 846 are directly aligned under the Director, PD, at headquarters. There are 53 buying and 24 contracting positions in AAFES-Europe, 16 positions in AAFES-Pacific and 13 positions in the Purchasing Policy Directorate. Also included are 5 contract positions that provide support in Taiwan. Wage costs, including fringe benefits and use of the average buyer wage for the 6 military positions, totals about $24.1 million per year, Table 4-1. The headquarters purchasing staff includes support-type positions, such as quality assurance, support and analysis, systems development, store customer service and specialized training. Productivity is about $11.2 million per buyer and $11.3 million per clerk, including support-type positions

(see Table 4-2).

TRENDS AND COMPARISONS

Exchange service FY 88 and FY 89 retail sales, excluding AAFES gasoline, photo processing, video rental and auto labor sales, are shown in Figure 4-4. Sales range from a high of $4.8 billion for AAFES to $352 million for MWRSPTACT exchanges. Of total exchange retail sales, AAFES accounts for 74% of the total, NAVRESSO for 21% and MWRSPTACT for the remaining 5 percent.

Distribution of sales between CONUS and oversea stores is detailed in Table 4-4. An estimated 90% of MWRSPTACT retail sales are from CONUS markets; this factor is high in comparison with NAVRESSO and AAFES because Marine Corps personnel in Okinawa are supported by AAFES. CONUS stores generate 69% of NAVRESSO sales and 59% of AAFES sales. The portion of oversea sales is significant when viewing inventory investment and turn rates because of the longer lead times required to support the oversea operations.

The replenishment methods (distribution channels) for NAVRESSO and AAFES are depicted in Table 4-5. Data for MWRSPTACT distribution channels is not applicable since centralized warehousing and distribution is not used by MWRSPTACT. For practical purposes, NAVRESSO and AAFES methods of replenishment are identical, although the degree of centralized warehouse support varies. PABs or warehouse support accounts for about one-half of purchases. About 30% is provided by vendor direct-to-store shipments and usually includes vendor in-store support (SPOs and open orders). About 8% is fashion or other consolidated purchases. The remaining amounts are one-time buys, open market buys, DPSC, etc.

NAVRESSO and MWRSPTACT data concerning the number of suppliers and supplier classification as small or large businesses was not available. AAFES supplier data is shown in Table 4-6. Of the 20,300 suppliers doing business with AAFES in FY 89, almost 93% were classified as small businesses (less than 500 employees) per the Small Business Administration definition.

FY 88 and FY 89 worldwide turn rates, including warehouse inventories, for the exchange services are shown in Figure 4-5. As expected, because of the absence of a centralized warehousing system and limited oversea sales, MWRSPTACT turn rates are higher than NAVRESSO and AAFES turns. All exchange services' FY 89 turns improved over FY 88.

FY 89 CONUS and oversea turn rates are illustrated in Figure 4-6. MWRSPTACT worldwide turns are shown because oversea sales are minimal. NAVRESSO had slightly more favorable turn rates than AAFES because of the less structured warehousing system.

Sales mix by major category grouping for NAVRESSO and AAFES is detailed at Table 4-7. The data presented includes only allocated sales in comparable merchandise departments. The majority of both NAVRESSO and AAFES sales are in the consumables and hardlines categories; AAFES softlines sales are slightly less than two percentage points more than NAVRESSO softlines sales.

Sales trends for major category groupings (allocated departmental sales) are shown for

AAFES and NAVRESSO in Table 4-8. MWRSPTACT departmental sales data was not available. When only comparable merchandise departments are included, NAVRESSO shows small sales increases in Consumables and Military categories, and flat (slight decreases) in Hardlines and Softlines. The AAFES Consumables grouping sales increase was impacted (by about $189 million) by assumption in April 89 of alcohol beverages from MWR. Departmental sales trends are shown in more detail in Table 4-9. Only allocated sales in comparable departments is illustrated. NAVRESSO posted sales decreases in more than half (18 of 34) of the commodity departments. (NAVRESSO explains the depressed sales were caused by a significantly reduced number of ship days in port in FY 89). AAFES showed decreases in 6 of 34 groupings; five of the AAFES departments with sales decreases also showed declines in NAVRESSO.

FY 89 retail initial markon percentages (initial gross profit before markdowns and inventory loss) for NAVRESSO and AAFES merchandise departments are shown in Table 4-10. Comparable data was not available for MWRSPTACT. This table highlights the differences in pricing strategies between NAVRESSO and AAFES. For example, NAVRESSO initial markons for softlines (men's, women's and children's) is significantly higher than AAFES initial markons. Since distribution channels are similar, this suggests the NAVRESSO sell prices to customers is higher. Conversely, NAVRESSO initial markons for spirits and wines and for records and tapes is significantly lower than AAFES markons. In this case, however, the distribution channels differ. AAFES centrally warehouses these departments and NAVRESSO generally buys from wholesale distributors; this suggests that the NAVRESSO profit structure is lower in these highly competitive categories.

4.3 CENTRALIZED AND DECENTRALIZED BUYING ORGANIZATIONAL ALIGNMENTS

Specific advantages and disadvantages are generally associated with various buying organizational alignments. A central buying staff yields certain advantages and has certain weaknesses that must be minimized if the buying function is to be both effective and efficient. Likewise, a completely decentralized buying staff has inherent weaknesses and strengths.

This section discusses, in general terms, the most significant strengths and weaknesses associated with centralized and decentralized buying alignments. Usually, an advantage for one type of organizational approach is a disadvantage for the other and vice versa.

ADVANTAGES and DISADVANTAGES

Buyer specialization is high on the list of advantages of centralized buying. Specialization allows the buyer to become an expert in a relatively narrow category of merchandise. The buyer is better able to study, monitor, predict and react to overall market trends and in-store sales results. This lack of specialization is one of the more serious weaknesses of a decentralized buying staff. The span of control for local,

in-store buyers is so broad that true expertise is not possible; many critical decisions may default to suppliers, some of whom may tend to be self-serving.

Improved buying power and leverage is a definite strength of centralized buying and a corresponding weakness of decentralized buying. Not only are vendor minimum order quantities more easily met under centralized buying, but lower cost prices may be negotiated because of larger order quantities. Volume discounts are often available and more easily achieved under centralized buying. Opportunity or forward buying, where one or more months supply is purchased at reduced, "deal" cost prices, may be maximized under centralized buying. The decentralized buyer must often pay higher cost prices because of smaller order quantities.

Centralized buying usually realizes the economies of scale needed for specialized support programs, including quality assurance, management information systems, distribution and transportation. Decentralized buying often can not realize the needed level of expertise in these specialized areas because of the lower volume of purchases.

Duplication of job related functions are eliminated under centralized buying, where a buyer may support multiple selling outlets. Usually, a more advantageous career progression is afforded the centralized buyer. Under the decentralized alignment, each job function is repeated at each buying office and often the buyer must leave the purchasing field to advance his or her career.

Transportation savings should be achieved under centralized buying. More favorable freight rates are available for larger quantities and often internal, organic vehicles may be used to move orders. Vendors may be more agreeable to meeting specialized packaging requirements on large quantity orders than on smaller quantities. Because of the smaller order quantities, decentralized buying often must pay higher, less-than-truckload transportation rates and is unable to coordinate transportation savings.

Buying for multiple stores offers the option of moving merchandise between stores, rather than buying more of an item that may be overstocked in some selling locations. While this is often too costly to pursue, it is an option not normally available to decentralized alignments.

Centralized buying allows for better internal control, coordination and direction; attainment of system wide programs, such as centrally sponsored sales promotions, is enhanced. Conversely, this standardization allows for less rapid flexibility than is present under decentralized buying, which may be more personalized and encourage innovation.

A decentralized alignment places the buying closer to the customer and allows for a better focus on local trends and on local competitors. The centralized buyer must rely on a feed-back system, supplemented by relatively infrequent store visits, to maintain contact with local trends and competitors, slowing reaction to localized needs.

A buyer in a decentralized

office has more of a "cradle to grave" responsibility than does a buyer in a centralized office. The decentralized buyer is aware first-hand of the results of a buy; the centralized buyer often perceives less responsibility. A centralized buyer may be more inclined to view the needs of a single store on a broader perspective and seem non-responsive to that store.

The vendor competitive base, i.e., the number of suppliers providing goods and services, may be reduced under a centralized system since some suppliers may not be able to compete with larger suppliers or handle the increased volume of business.

4.4 ANALYSIS AND DISCUSSION

COMPETITION AND LIMITATIONS

In the highly competitive world of retailing today, it is imperative that the exchange services provide their customers with good value - quality products at low prices. While the exchange services have and still are providing good value, the competitive pressures are greater now than ever before. These pressures are from without and from within the military community. There are also DoD imposed limitations that directly inhibit the ability of the exchange services to improve customer service levels.

The giant discount chains are battling for market share. Their expansion plans are ambitious and new prototype stores featuring fewer SKUs are being opened in markets previously bypassed for standard format discount stores. At the same time, the swing into specialty retailing is intensifying. Stores offering limited merchandise categories (office supplies, computers, toys, etc) are highly successful, as are huge discount/food combos - the super stores - at the other end of the spectrum.

Warehouse clubs are making a big splash and expanding rapidly. Merchandising strategies are being revamped and often include an everyday low-price approach with reduced margins on key image items.

Although the exchange services may not be targeted directly for competition by the commercial chains, the results are the same - **meet the competition or lose customers.** More importantly, the DoD limitations on items authorized for sale in exchanges and the cost price limitations on some items authorized for sale adversely impact the exchange services' ability to provide the level of service demanded by customers in today's retail world. This results in the loss of sales and in revenue.

Simultaneously, there's increased competition for the exchange services from within the military community. Under the banner of improving customer convenience, the commissaries continue to expand SKUs, often with significant adverse impact on exchange services' sales and earnings and their ability to support MWR programs. This comes at a time when there is increased need for more earnings to help offset the decrease in appropriated fund support for MWR programs.

Ironically, because of the decrease in appropriated MWR funding, local commanders are more inclined to allow on-base competition, particularly in certain food and specialty retail operations, with exchanges by other MWR revenue- generating activities. While this practice may provide some short term relief on an installation basis, it is counter- productive over the long term.

ASSUMPTIONS AND LIMITATIONS

Although differences exist in the efficiencies and effectiveness of the buying and contracting functions of the exchange services, the key assumption underlying the basis of this chapter is that each of the exchange services provide adequate and acceptable levels of customer service to their patrons. A detailed and statistically unbiased study of the exchange services' <u>net cost prices</u> for identical items within various commodity categories is beyond the scope of this study. Logically, there should be significant differences in cost prices because of the different buying approaches and distribution channels used by the exchange services. For the purposes of this chapter, the effectiveness and efficiency of the buying functions of the separate exchange services are considered equal in terms of negotiating cost prices.

The time frame allowed for completion of the study did not allow independent development or verification of data. Information provided by the exchange services, both formally and informally, is used as presented, unless other wise noted.

Assumptions and limitations specific to functional area are noted below.

BUYER RESPONSIBILITY AND AUTHORITY

Although the functional responsibility and authority of buyers is assumed to be equal for this chapter, there is, in fact, a wide difference in the actual responsibilities and authority of the exchange services' buyers. The fact that differences exist was also noted by an industry group, the American Logistics Association (ALA).

INVENTORY CONTROL (MANAGEMENT) SYSTEMS

The merchandising control and replenishment systems used by the exchange services' are significantly different, but are assumed to accomplish the minimum functions needed for effective control of inventories.

BUYER STAFFING AND PRODUCTIVITY

Computation of the productivity levels using retail sales (including gasoline and military clothing) and the sum of buying and contracting positions assumes the ratio of retail buying to non-retail and non-resale buying and contracting is the same for the exchange services.

The adjustments for performance of non-buying related functions (40% for buyers and 20% for clerical positions) may be overstated.

PURCHASING AND INVENTORY MANAGEMENT FOCUS GROUP

Each of the exchange services provided representatives to serve on a Purchasing and Inventory Management Focus Group. The representatives acted as technical advisors and provided information

and data relative to their exchange services and made specific recommendations concerning the feasibility and desirability of consolidating the purchasing function.

While at the initial focus group meeting, representatives did reach several agreements on specific points, a consensus of all representatives, including the chairman, was not reached on the feasibility and desirability of consolidating the purchasing function.

The general positions and conclusions of the exchange service representatives are summarized below. Written comments, recommendations, concerns and opinions, as submitted by the representatives, are included in full at Attachment 1 through 3, Appendix B.

The NAVRESSO attendees agreed that only AAFES had the infrastructure in place with the capacity to absorb combined operations. They acknowledged that elimination of the Navy procurement and contracting function would result in the elimination at various locations; they felt the savings from these reductions would be offset by increases in the consolidated buying staff. NAVRESSO representatives strongly felt there was a strong risk associated with consolidating that would impact customer service and decrease sales. The NAVRESSO attendees recommended continuing the separate exchange services, i. e., maintaining the status quo. Their comments and recommendations which are based on intangible factors and difficult to quantify, are at Attachment 1, Appendix B.

The MWRSPTACT representatives felt that, while consolidation was probably feasible and would yield some efficiencies, it would not be cost effective. The MWRSPTACT attendees recommended continuing the status quo, with MWRSPTACT exchanges operating as a division of the Marine Corps Consolidated MWR system. They felt that consideration should be give to consolidating all MWR businesses due to increased efficiencies, cost savings and loss of appropriated fund support of MWR activities. Text of the MWRSPTACT attendees' input is at Attachment 2, Appendix B.

The AAFES representatives felt that consolidation appeared to be cost effective and desirable from a statistical viewpoint. They were concerned that projected savings could be greatly affected by several intangible issues, including the significant philosophic differences between the exchange services, the apparent absence of the attitude (compromise, cooperation and willingness) needed to make consolidation successful, the possibility of passing the point of "diminishing returns" where centralization yields inefficiencies rather than efficiencies, the need for highly skilled and highly compensated management personnel and the potential political risks associated with a very large, highly visible organization. AAFES concerns are at Attachment 3, Appendix B.

Subsequent to the initial focus group meeting, NAVRESSO made a formal presentation showing that consolidation of purchasing would result in a 15 percent loss in NAVRESSO and MWRSPTACT sales and in a $25 million reduction in profits. In response to a request to provide the basis for the sales

loss and profit reduction, NAVRESSO provided the rationale shown for the projections. Essentially, the rationale involved using the difference in sales volume of two dissimilar stores (Fort Meyer and Henderson Hall) to extrapolate systemwide sales and profit loss. Since this methodology seemed to lack a valid procedural foundation, a certified public accountant firm (KPMG Peat Marwick) was asked to review the rationale for the projection. KPMG Peat Marwick advised "... there appears to be insufficient data to project anticipated losses in the event of the consolidation of the military exchange systems." These documents are at Attachments 4-1 through 4-3, Appendix B.

During a second meeting of the focus group, NAVRESSO revised the estimated sales loss to 12 percent ($160 million) and $16 million loss in profit. MWRSPTACT revised the estimated sales loss to five percent ($20 million) and the profit reduction to $1.5 million. Additional rationale to support the estimates was given and is at Attachment 4-4 Appendix B.

The NAVRESSO position is largely based on the assumption that centralized purchasing would be less responsive to local customer demographics and competitive conditions. Conversely, we would expect a consolidated exchange system to maintain or increase niche marketing initiatives and sales opportunities. Review of historical sales trends, sales contribution by merchandise category and replenishment methods suggests there are many opportunities for sales increases within a consolidated exchange system. Given the differences in focus group viewpoints, a conservative estimate of flat sales is used in the study.

There are factors that may impact adversely on NAVRESSO sales, but not due to consolidation. If more Navy commissaries begin selling cigarettes, NAVRESSO tobacco sales and earnings will decrease, which may not be totally offset with other categories.

Also, continued emphasis on physical fitness and good health may decrease the customer base for tobacco products, wines, beers and distilled spirits for all exchange services. Any number of social, as well as state and federal legislative actions, could make consumption of these types of products decline in popularity and acceptance.

DISCUSSION

ORGANIZATIONAL STRUCTURE

To a degree at least, the exchange services' buying organizational structures reflect the Military Departments' philosophies concerning the relationship of the exchange services to the Departments' overall command structure. Essentially, AAFES is a centralized system, NAVRESSO is a more regionalized system and the Marine Corps is decentralized. In today's highly competitive retail environment, centralized operations with system-wide support systems (MIS, distribution, policy, etc.), offer many advantages.

Centralized support and decentralized management is the strategy projected by the retail industry for future successful retailers. Selected quotes from retail industry consulting firms

and successful retail executives are detailed at Attachment 5 Appendix B.

BUYER RESPONSIBILITY AND AUTHORITY

The responsibility and authority of buyers within each of the exchange systems varies significantly.

MWRSPTACT

MWRSPTACT buyers, for example, determine requirements, select items and sources, establish sell prices, but have no contracting officer authority. While they may be responsible for merchandise categories, it is the Retail/Exchange Officer, who has the formal authority to commit (obligate) the MWRSPTACT retail operations in business transactions. The breadth of category responsibility facing MWRSPTACT buyers may hinder buyer proficiency in all categories of merchandise.

NAVRESSO

At NAVRESSO actual buying tasks are divided between buyers at headquarters, FSOs and NRAs, depending on merchandise category or the existence of a special program. Contracting officer authority within NAVRESSO is limited by position and by type of purchase. Buyers have relatively low dollar levels of authority. A FSO or NRA buyer's authority for open market purchases (buys not covered by contract or PABs), for example, is limited to $5,000; this is further limited to emergency situations at some NRA locations. This limitation could be viewed as a way to further standardize by encouraging the use of PABs and contracts. NAVRESSO reports that wherever possible, they separate the responsibility for identifying or generating the requirement for an item or service from the individual who does the buying or contracting. With some exceptions, headquarters buyers within the hardlines and consumables categories do not actually buy merchandise; they negotiate and publish PABs, which may then be used by FSO and NRA buyers without further negotiation (PABs may be viewed as an "informal" contract). So, buying tasks are divided between the headquarters and the FSO or NRA buyer; no single buying level has total responsibility or authority for most hardlines and consumables merchandise. In the softlines categories, the headquarters buyers pre-select suppliers for subsequent review by FSO and NRA buyers. Buy decisions are influenced to the extent of the pre-selection conducted by the headquarters buyers.

At NAVRESSO, forward-buys at "deal prices" are generally made within the constraints of regular open-to-buy procedures and turn rate objectives. This may limit the effectiveness of these important procedures because buy-in quantities may be constrained by the current overall inventory posture in comparison with planned objectives.

NAVRESSO reports that Procurement Management Reviews (PMRs), which are used as a means to evaluate purchasing performance as well as identifying areas that may be vulnerable to fraud, waste and abuse, are conducted on a recurring basis by both NAVRESSO and their higher headquarters. PMRs are considered essential by NAVRESSO.

AAFES

All facets of the buying functions are vested with the AAFES buyers, who determine that requirements exist, determine sources of supply and the distribution channel to be used, order and reorder quantities, establish pricing, etc.

Centralization of the buying function allows a high degree of specialization where the buyers become very proficient in a relatively narrow category of merchandise. This provides for a high level of expertise within each merchandise category. The Contracting Officer Authority (authority to obligate funds) vested with the AAFES buyers is based on personal grade and is $150,000 for a UA12 Buyer. Support systems, such as MIS and transportation and distribution, allow efficiencies and cost savings/avoidances to be maximized.

Periodic reviews of buying and contracting functions are conducted by the Purchasing Policy Directorate and by the AAFES Audit Division. These reviews address compliance with established purchasing policies and procedures and the effectiveness of overall purchasing strategies.

A forward-buy program, supported by separate, clearly defined open-to-buy procedures and a specialized computer-based economic model, helps lower the cost-of-goods when "deal prices" are offered by suppliers. During FY 89, the monthly inventory of goods bought under these special open-to-buy procedures averaged $34.6 million per month.

INVENTORY CONTROL (MANAGEMENT) SYSTEMS

The capabilities of the merchandising systems of the exchange services vary significantly and are discussed in detail in the Management Information Systems chapter. From a buying and contracting perspective, the crucial systems capabilities include a standardized methodology of item (SKU) numbering and supplier identification, and capture of SKU sales data (POS scanning) and EDI capacity. Standardized numbering of items (SKUs) and identification of vendors is necessary to allow identification and projection of SKU- specific and general sales trends on a regional or exchange service basis. Store level trends may be tracked and predicted without standardized numbering procedures, but "roll-up" of sales data is virtually impossible. Point-of- sale data capture is essential to allow tracking of SKU sales, as opposed to purchases; scanning, in lieu of key- entry, is the preferred capture method. EDI capability is necessary to allow maximizing sales, reduction of expenses and control of inventory levels.

Neither MWRSPTACT nor NAVRESSO have standardized SKU numbering and vendor identification procedures; therefore, each MWRSPTACT exchange, NAVRESSO FSO and independent NRA assign items and vendor identification numbers. This precludes the roll-up of item sales data or vendor performance data. The AAFES item and vendor data bases are standardized and allow identification of supplier and SKU trends at store level or on a roll-up basis.

POS data capture is accomplished by all exchange services. MWRSPTACT POS is limited to key-entry of SKU information with no price look-up

(PLU) capability. NAVRESSO and AAFES employ POS scanning at major locations.

MWRSPTACT has no EDI capability. NAVRESSO and AAFES are significantly behind commercial retailers in the establishment of EDI partnerships; both exchange services are dedicating additional resources to this vital area.

The only infrastructure which may have the capacity to absorb the combined operation is AAFES.

PRICING POLICY

All of the exchange services approach pricing in a similar manner. The goal of each is to provide customer savings averaging at least 20% and items of necessity carry lower markups than do luxury items.

NAVRESSO and AAFES headquarters have published markup guidelines, providing uniform markup percentages for each merchandise category. The MWRSPTACT has no centrally published markup percentage guidelines, but each separate exchange develops category markup percentages.

The NAVRESSO and AAFES pricing guidance provides definitive procedures for meeting local competitor's sell prices; MWRSPTACT policy specifies that competitive prices are necessary. In the early 1980's, AAFES established the policy (Extra Value Program) to meet loss-leader pricing on select highly visible, image items. The NAVRESSO and MWRSPTACT adopted similar programs (Value Pricing and Price Leader programs) in May 1990. Additionally, AAFES is testing "everyday low prices" at three locations; under the test local AAFES sell prices are adjusted to meet all competitors' advertised prices and frequent price surveys are conducted locally to align everyday sell prices.

Only the MWRSPTACT establishes sell prices for all items by individual location; both NAVRESSO and AAFES basically have uniform sell prices. MWRSPTACT prices for an item could vary significantly from location to location because local buying usually means different cost prices and because of locally developed category markup percentages.

Much of NAVRESSO's pricing is standardized. NAVRESSO reports that about 12% of buys are open market purchases, which are priced by the FSO or NRA using standardized markup percentages. The remaining purchases are covered by PABs, which have recommended sell prices, contracts and consolidated or commitment buys, which have standardized sell prices.

AAFES policy is to have substantially uniform sell prices worldwide. Since buys are centrally controlled, this is achieved for the vast majority of merchandise. To achieve a sharper pricing image, AAFES is using "everyday-low-price" strategy, which results in variable markons by sub-category. Prices are determined from local market price surveys conducted at competitor stores, such as Wal-Mart, KMart, Target, et al. Under the uniform sell price approach, actual customer savings vary by competitive market area, with more savings realized for customers in areas with little retail competition and less for those in highly competitive areas.

Price leadership is an important strategy in today's retail world as evidenced by the move by major retailers toward everyday low prices and guarantees to meet competitor's pricing. The exchange services have policies that allow competitive sell prices, but the special pricing programs (Extra Value, Price Leader, and Value Pricing Programs) are the only indications of formal programs to meet commercial competitor loss-leader pricing. These programs are very limited in scope (number of SKUs) and may not be effective in establishing or maintaining an image of price leadership. However, the effectiveness of the policies allowing local exchanges to set competitive sell prices could not be determined. Further discussion of pricing and special programs can be found in Chapter 7 (section 7.6 and 7.10).

While the average savings computed by the independent companies performing price surveys for NAVRESSO and AAFES can not be interpreted as a structured comparison of AAFES and NAVRESSO sell prices, the results suggest that AAFES sell prices may be lower than NAVRESSO sell prices for similar items.

BUYER STAFFING AND PRODUCTIVITY

The productivity levels shown in Table 4-2 confirm the logical conclusion that centralized buying should yield greater dollar sales per position than decentralized buying because of duplication of functions under the decentralized alignment.

The productivity levels shown should be viewed in order of magnitude, rather than as precise levels of productivity. This is necessary because of the assumptions underlying the calculations.

The ratio of retail to non-retail procurement and contracting was considered equal for the separate exchange services. This assumption was necessary because data showing the value of non-retail purchases was not available. This assumption probably lowers the relative productivity of AAFES because of extensive contracting for construction, organic vehicles, standardized food programs, etc.

Military positions assigned the exchange services were excluded from productivity calculations. This probably overstates the productivity levels of NAVRESSO and MWRSPTACT since the military positions are involved to some degree in the procurement process - all have contracting officer authority (in some cases, only the military positions are contracting officers). The degree of involvement could not be determined.

Productivity levels adjusted for non-buying functions accomplished by NAVRESSO and MWRSPTACT buyers and clerks are shown in Table 4-3. The productivity for centralized buying is double that of the decentralized alignment.

Since only commercially available products are sold by the exchange services, it is estimated that almost all (90% plus) of the items bought and sold by the separate exchange services are common items; those items not exactly identical are comparable in the sense of being within common merchandise categories. So, all items now bought and sold

in MWRSPTACT and NAVRESSO stores could be supplied by a fully centralized buying staff.

Under a completely centralized buying scenario and using the productivity levels now achieved by the AAFES buying staff, the buying and contracting functions of the combined exchange services could be accomplished by a staff of about 647 buyers and 641 clerks. Table 4-11 shows the number of positions required to support each exchange service.

TRENDS AND COMPARISONS

The differences in accounting reporting procedures makes direct comparisons of data difficult. Where possible, data was adjusted to allow comparison of compatible information.

NAVRESSO and MWRSPTACT retail inventories turn faster than the AAFES inventory. Detailed analysis of all factors impacting turn rates is beyond the scope of this review.

Two factors, sales distribution and centralized warehousing, impacting turn rates require comment since there are differences between the exchange services. Sales distribution, i.e., the proportion of CONUS to oversea sales, may influence turn rates. Generally, a higher proportion of overseas sales lowers turn rates because of the longer lead times incurred in supporting the overseas stores. Similarly, a large scale, central warehouse configuration usually results in additional inventory levels, even though the warehouse operation may be highly efficient. Given these two factors, the turn rates achieved by the exchange services rank as would be expected: MWRSPTACT with the highest turns, followed by NAVRESSO, and then AAFES.

The additional inventory required to support NAVRESSO and MWRSPTACT sales at the AAFES turn rates is estimated in Table 4-12. When valued at cost prices, the additional inventory carries an opportunity cost of about $3.1 million.

Despite the differences in the organizational alignment of the purchasing function, the distribution channels (replenishment methods) of NAVRESSO and AAFES are almost identical. This is dictated to a large degree by the overall sales mix (proportion of consumables, hardlines and softlines sales), which is very similar between NAVRESSO and AAFES, as presented in table 4-9.

Although supplier (vendor) profile data was not available, a concern was expressed that under a centralized purchasing alignment some number of small suppliers would be adversely affected. The AAFES data suggests that small suppliers are not affected by centralization. In 1989, 93% of AAFES vendors were categorized as small business (less than 500 employees), and they received 59% of the payment (see Table 4-6).

The retail initial markons (Table 4-10) suggest that NAVRESSO sell prices may be somewhat higher than AAFES sell prices. Although DoD ASER regulations state that profit should be a secondary consideration when establishing sell prices, i. e., the patron should receive an immediate benefit in the form of lower prices, there could be a short term impact on NAVRESSO (MWRSPTACT comparable data was not available) earnings if the AAFES sell price structure was adopted and if sales

did not increase.

4.5 CONCLUSIONS

For all practical purposes, the goods and services provided by the exchange services are identical. An estimated 90% plus of the items sold are identical and the remaining items are comparable in the sense of being within common merchandise categories.
Efficiencies (cost savings) can be realized by consolidating the exchange services' buying and contracting functions.

The AAFES system is capable of supporting the combined sales of MWRSPTACT and NAVRESSO.

There would be no adverse impact on customer service levels or sales as a result of centralizing the buying and contracting functions per se. There could be short term negative impacts on in-stock levels and sales if consolidation is phased in too rapidly or if adequate training is not provided.

There would be little, if any, negative impact on the vendor base resulting from consolidation. Generally, the same suppliers (vendors) are used by the exchange services.

Small businesses should not be adversely impacted by consolidation.

Consolidation will not result in the loss of leverage in negotiations with industry. Competitive situations exist because of competitive products and competitive suppliers.

Some suppliers, primarily the military representative firms, may view consolidation as a potential loss of sales opportunity in that there would be no alternate military buying office.

4.6 RECOMMENDATIONS

That the purchasing and contracting functions of the military exchange services be consolidated into the existing AAFES infrastructure consolidated procurement would require an incremental increase over current AAFES staffing of about 337 positions with incremental wages, including fringe benefits, of about $9.8 million (see Table 4-11).

CHAPTER 5

DISTRIBUTION/TRANSPORTATION

OVERVIEW

The review of the Distribution/Transportation subsystem of each military exchange system included an unconstrained baseline assessment and the identification of increased efficiencies in both overhead and appropriated fund support while maintaining or improving service levels to customers.

The major issue is whether it is feasible and cost effective to consolidate this functional area among the three service exchange systems. A summary of the distribution/transportation systems of each exchange system follows.

CURRENT SYSTEMS

NAVY EXCHANGE PHYSICAL DISTRIBUTION

The Navy Resale and Services Support Office is regionally structured into eight Field Support Offices (FSOs) which provide local exchange support and direction. FSOs exist at the following locations:

Davisville, Rhode Island
Mechanicsburg, Pennsylvania
Norfolk, Virginia
Jacksonville, Florida
San Diego, California
Oakland, California
Auburn, Washington
Pearl Harbor, Hawaii

In addition, there are several independent exchanges that operate distribution centers.

An East Coast Fashion Distribution Center at Bayonne, New Jersey processes soft goods purchased for all retail locations worldwide.

Purchase of resale merchandise is accomplished both centrally at Navy Resale and Services Support Office, (NAVRESSO) Staten Island, New York for Price Agreement Bulletins, contracts and consolidated purchases, and decentrally at Field Support Offices and independent exchanges for material.

The FSO structure includes a central distribution center and accounting, merchandising and procurement departments which support local operations.

The split between FOB destination and FOB origin of inbound freight is approximately 60 percent and 40 percent respectively; FOB origin shipments are routed and controlled by NAVRESSO Staten Island, or by FSO Traffic Managers depending on whether the purchase order was generated by headquarters or the field.

Approximately 60 percent of all purchases are processed through FSO distribution centers or warehouses supporting free standing exchanges; the remaining 40 percent is shipped direct to the respective retail location for a variety of reasons, e.g., storage costs, transportation costs and perishability of product. Shipments from FSO distribution centers to retail locations are handled by an in-house fleet with the exception of FSO Jacksonville which uses common carriage. At the Oakland, Auburn and Norfolk FSOs, the exchange delivery fleets have consolidated under FSO control to achieve a more efficient use of material and personnel resources. Several FSOs are additionally tasked to support specific overseas locations:

FSO LOCATION	SUPPORTED OVERSEAS LOCATIONS
Auburn Jacksonville, FL	Adak, Alaska Roosevelt Roads, Puerto Rico, Guantanamo Bay, Cuba
Oakland, CA	Pacific Overseas Area/Far East
Norfolk, VA	Atlantic Overseas Area/Europe
Davisville, RI	Argentia

Overseas warehouses listed below receive support from the applicable FSO distribution center. In some cases, a large overseas warehouse may receive source-loaded merchandise direct from stateside vendors, where requirements are met on a monthly basis. At overseas locations, merchandise is further distributed from the overseas warehouse to stores by either organic fleet or common carrier.

Overseas refrigerated items (freeze/chill) are received from Defense Personnel Support Center (DPSC) overseas depot where available (United Kingdom, Naples, Yokosuka) or direct from CONUS vendors (all others) where this merchandise is consolidated and transshipped by Naval Supply Center Norfolk (Europe), Military Ocean Terminal Bay area - Dreisback, Oakland (Pacific), or DPSC Defense Subsistence Office Jacksonville (Caribbean).

These overseas Navy Exchanges operate warehouses

Naples, Italy
Yokosuka, Japan
Subic Bay,
Philippines Islands
United Kingdom
Adak, Alaska
Bermuda

Argentia, Newfoundland
Roosevelt Roads, Puerto Rico
Guantanamo Bay, Cuba
Rota, Spain
Guam, MI
Exmouth, Australia
Keflavik, Iceland

SC12

NAVY RESALE AND SERVICES SUPPORT OFFICE
NAVY EXCHANGE DIVISION
DISTRIBUTION CENTER OPERATING STATEMENT

FOR WORLDWIDE

EXCHANGE NO:
PERIOD ENDING: 28 JAN 90 SC12

CURRENT MONTH

DESCRIPTION	BUDGET	% TO ISS	ACTUAL THIS YEAR	% TO ISS	% VAR BUDGET	% VAR LY	ACTUAL LAST YEAR	% TO ISS
TOTAL ISSUES AT COST	26378610		33894723		285	177	28793195	
DIRECT PAYROLL	965802	37	962743	28	3-	124	858797	30
EMPLOYEE BENEFITS	224577	9	90249	3	598-	1205	40937	1
FREIGHT-IN	276398	10	394857	12	429	431-	694544	24
FRGHT-DLVRY EXP OUT	205615	8	211977	6	31	867	113564	4
OTHER DIRECT EXPENSES	4282-		193325-	6	4148	2110	62158-	2
TOTAL DIRECT EXPENSES	1668110	63	1466502	43	121-	108-	1643686	57
OVERSEAS ADMIN EXP			21367	1				
GENERAL PAYROLL	33543	1	41986	1	252	786	23512	1
EMPLOYEE BENEFITS	8311		8540		28	247	6847	
CENTRALLY FUNDED EXP	72761	3	97686	3	343	188	82346	3
OTHER GENERAL EXPENSES	341249	13	478483	14	402	126	424967	15
TOTAL GENERAL EXPENSES	455864	17	648064	19	422	205	537674	19
COST OF MARKONS-INV ADJ	12680		42733	1	2370	325-	67339	2
REIMBURSABLE RCS COSTS			66112-	2		48	63068-	2
TOTAL OPERATING EXPENSES	2136654	81	2091188	62	21-	41-	2181832	76
INCOME								
SERVICES CHARGES	9600		11982		248	1146	5582	
OTHER INCOME	43424	2	442178	13	9163	2439	32902	1
PURCHASE DISCOUNT TAKEN	60885	2	84266	2	384	3216-	6898-	
TOTAL INCOME	113909	4	538427	16	3727	6046	31587	1
TOTAL NET OPER EXP - CURR YR	2022745	77	1552761	46	232-	276-	2150045	75
UNDIST OPER EXP - PRIOR YR								
OPERATING EXPENSES ALLOCATED			2780928	82		66	2607552	91
BAL OF OPERATING EXP TO ALLOC	2022745	77	1228167-	36	1607-	1684	457506-	16
TRADE DISC & ALLOW - CURR YR	105771	4	179168	5	694	827	98092	3
UNDIST DISC & ALLOW - PRIOR YR								
TRADE DISC AND ALLOW ALLOCATED			225159	7		12-	227865	8
BAL TRADE DIS & ALLOW TO ALLOC	105771	4	45990-	1	1435-	646-	129772-	5
NET BALANCES TO BE ALLOCATED	1916974	73	1182178-	35	1617-	2607	327734-	11

YEAR TO DATE

DESCRIPTION	BUDGET	% TO ISS	ACTUAL THIS YEAR	% TO ISS	% VAR BUDGET	% VAR LY	ACTUAL LAST YEAR	% TO ISS
TOTAL ISSUES AT COST	583605886		543178107		69-	5-	546148146	
DIRECT PAYROLL	13200822	23	13023079	24	13-	95	12347810	23
EMPLOYEE BENEFITS	3228782	6	3005767	6	69-	53	2855305	[illegible]
FREIGHT-IN	4499470	8	5559823	10	236	146	4850551	9
FRGHT-DLVRY EXP OUT	2817888	5	2273086	4	193-	147	1981381	4
OTHER DIRECT EXPENSES	72770		337747-		15641-	3595-	130172	
TOTAL DIRECT EXPENSES	23819732	41	23524010	43	12-	61	22169200	41
OVERSEAS ADMIN EXP			234567					
GENERAL PAYROLL	515912	1	469370	1	96-	99	424320	1
EMPLOYEE BENEFITS	145057		110126		241-	94	100683	
CENTRALLY FUNDED EXP	925664	2	1245706	2	346	99	1137608	2
OTHER GENERAL EXPENSES	4129803	7	4601376	8	114	107	4158046	8
TOTAL GENERAL EXPENSES	5710436	10	6650147	12	165	145	5810658	11
COST OF MARKONS-INV ADJ	165645		215858		302	144-	251894	
REIMBURSABLE RCS COSTS			665586-	1		14	643483-	1
TOTAL OPERATING EXPENSES	28701813	51	28732229	55	1	78	27590269	5
INCOME								
SERVICES CHARGES	115200		103136		105-	118-	116875	
OTHER INCOME	561488	1	913585	2	627	261	724384	
PURCHASE DISCOUNT TAKEN	807703	1	1007077	2	247	4	1002800	2
TOTAL INCOME	1484391	3	2023799	4	363	97	1844061	3
TOTAL NET OPER EXP - CURR YR	28217422	48	27708429	51	18-	76	25749208	47
UNDIST OPER EXP - PRIOR YR			2150986	4		107	1843942	3
OPERATING EXPENSES ALLOCATED			28306315	52		113	25439148	47
BAL OF OPERATING EXP TO ALLOC	28217422	48	1553109	3	945-	278-	2151002	4
TRADE DISC & ALLOW - CURR YR	1708492	3	2116532	4	239	43-	2211981	4
UNDIST DISC & ALLOW - PRIOR YR			290786	1		202-	364413	1
TRADE DISC AND ALLOW ALLOCATED			2067876	4		95-	2285603	4
BAL TRADE DIS & ALLOW TO ALLOC	1708492	3	339441	1	801-	167	290790	1
NET BALANCES TO BE ALLOCATED	26508930	45	1213668	2	954-	348-	1860211	3

See Figure 5-1 which shows the locations of both stateside and overseas Navy Exchange distribution centers.
For FY 89, Distribution Center expenses were 5.5 percent of issues at cost (as noted on Line 30 of the operating statements which follows). In addition included is a summary of the individual distribution center operational expenses.

NAVRESSO DISTRIBUTION CENTER EXPENSES

FSO/FDC	M$	% TO ISSUES(AT COST)
Norfolk	3.37	6.0
Jacksonville	3.07	5.3
San Diego	4.22	4.7
Oakland	3.03	7.0
Davisville	1.80	7.9
Mechanicsburg	1.64	6.0
FDC Bayonne	2.34	5.0
Auburn	1.57	5.3
Pearl	2.72	5.9
Great Lakes	1.07	4.7
Pensacola	1.22	5.4
Subic	1.22	4.2
United Kingdom	.61	5.9
Yokosuka	1.87	4.7
Total	29.7	5.5

MARINE CORPS TRANSPORTATION AND DISTRIBUTION

The Marine Corps Morale, Welfare and Recreation Support Activity (MWRSPTACT) does not operate central distribution activities. Certain exchanges do operate contiguous warehouses or remote warehouses in support of base exchange resale activities. The Marine Corps Exchange System purchases merchandise primarily from Purchase Orders and direct delivery contracts. All merchandise is received at the warehouse/store level by trucks or parcel post. It is then separated and is either put into a slot or delivered to the retail activity.

Merchandise is usually distributed using the packing slips to the main store and branch activities on a prescribed timetable. Transportation is provided by truck or van from the warehouse to the various branches and main store. Direct delivery merchandise is on a contract dictating a specific assortment and price. Distributors warehouse, ticket, order and in some cases stock the shelves. The cost of merchandise procured through distributors includes their distribution expense. See Figure 5-2 for MWRSPTACT exchange locations.

ARMY AND AIR FORECE EXCHANGE SERVICE (AAFES) DISTRIBUTION/ TRANSPORTATION

AAFES Distribution organization consists of 24 distribution centers, located in CONUS, Europe and the Pacific to support exchanges worldwide. These centers occupy approximately 10.4 million square feet of space, support over 12,500 facilities, carry an average inventory of approximately $600 million, and issue $332.5 million monthly. The decision to stock a category of merchandise in a distribution center versus direct delivery to the stores is based on economic analysis conducted by the buyer using a mathematical model. Three of these distribution centers (two in CONUS and one in Germany) were recently mechanized.

The Dan Daniel Distribution Center in Newport News, VA, supports facilities along the eastern seaboard and Europe with general merchandise. In addition, certain other items, such as shoes, are supplied worldwide. The Atlanta Distribution Center, located in Forest Park, GA distributes fine jewelry, prerecorded music(e.g., tapes, compact disks, cassettes), military uniforms, fashion shoes, and exchange catalog merchandise worldwide. Additionally, it distributes general merchandise to all exchanges east of the Mississippi, including facilities in Europe, as well as various other selected items to other exchanges worldwide.

Fashion and seasonal clothing are distributed to all exchanges worldwide from the Fashion Distribution Center in Dallas and the Fashion Distribution Shoe Activity co-located with the Atlanta Distribution Center.

The new, mechanized distribution center in Waco, Texas supports exchanges east of the Rockies and west of the Mississippi. The Dayton Distribution Center supports facilities located in the north central United States. The Oakland Distribution Center,

Oakland, California, provides general merchandise to stores west of the Rockies, including Alaska, and throughout the Pacific; whereas, the Norton Distribution Center supports facilities in southern California and Arizona.

In overseas locations (Europe and Pacific), with the exception of the mechanized distribution center in Giessen, Germany, all distribution centers are relatively small operations and provide support to in-country stores for high volume and bulky items. The Giessen facility provides support in basic merchandise to all AAFES facilities in Europe. Moreover, in most of these countries, the capability exists to process chill and frozen merchandise for both retail and food facilities. Figure 5-3 reflects the AAFES distribution center locations throughout the world.

In addition to receiving, storing and issuing merchandise carried, most of the distribution centers handle a considerable amount of transshipped merchandise which is not considered as a part of their inventory. These store shipments are received from vendors and/or other distribution centers for delivery to the retail facilities located in thegeographical area served by the center. Overall, this category of shipments constitutes approximately 11 percent of the total dollar shipments handled by all the distribution centers.

All distribution centers are supported by a computer-based system. The newly mechanized distribution centers have a real-time, stand-alone computer system called Warehouse Management System (WMS). The non-mechanized distribution centers are supported by a centralized Warehouse Locator System (WLS) resident on the mainframe at AAFES headquarters in Dallas, Texas. The facilities submit their requirements using electronic means and these are processed in one to three days. Shipments from distribution centers are received by the store on an established frequency ranging from one to five deliveries per week. Larger stores receive shipments almost daily.

AAFES transportation includes both traffic and vehicle management responsibilities. Vehicle management responsibilities are shared with headquarters and the distribution center managers. Headquarters sets maintenance standards, driver policy, cost controls and integrates schedules for inter-distribution center movements. The distribution center manager sets schedules for store deliveries, and is responsible for the routine dispatch and maintenance of the vehicles assigned to his facility. The AAFES cargo fleet worldwide is comprised of 612 trucks, 623 tractors, and 1358 trailers.

Traffic management, rate negotiation, freight audit, and landed cost evaluation are done centrally. Routing of FOB origin inbound freight is semi-centralized with transportation centers having selected routing responsibilities. AAFES has transportation centers located in Bayonne, New Jersey and Oakland, California which are primarily responsible for the booking of export cargo with the Military Traffic Management Command. In FY 89, AAFES exported over 35,000 seavans. The transportation center in Yokohama, Japan, schedules and books cargo procured in the

Pacific destined for Europe and serves as a breakbulk/consolidation point for the Pacific area. The transportation center in Rotterdam, Holland, oversees the import of containers destined for the Far East. AAFES also has contract consolidators in Chicago, Illinois and Brooklyn, New York, who receive and process vendor freight originating in their respective drawing areas.

At present, the CONUS and European distribution centers report to the Chief of Distribution at AAFES headquarters in Dallas. Effective fiscal year 1991, the Pacific facilities will be integrated into this central organization.

In FY 89, AAFES Distribution Center expenses were 6.4% of issues after adjusting for headquarters personnel charged to from that cost center. See the attached statement memorandum dated 20 July 1990 and summary of the Distribution Center expenses.

MEMORANDUM

20 July 1990

From: Anthony Blackburn, NAVRESSO FMGA
To: Chairman, Distribution/Transportation System
Jones II Commission

Subj: REVIEW OF AAFES DISTRIBUTION ISSUE/COSTS

Encl: (1) Pro Forma AAFES Distribution Issues/Costs
for year ending 22 Jan 1990

1. Enclosure (1) has been reviewed and the following is the findings of the undersigned.

- Lines 10 and 11 represents cash on trade discounts allowed by vendors obtained through the procurement function, not cost savings (credits) attributable of the distribution function.

- Line 12 distribution overhead totaling $14,200, represents administrative overhead included in the AAFES distribution costs, but not similarly treated in the NAVRESSO accounting equation.

2. Based on the above, recommend the following adjustments to enclosure (1) to facilitate comparing NAVRESSO and AAFES expenses.

Distribution expenses	$218,457	
Less: Distribution overhead	(14,200)	
Adjusted expenses		$204,257
Adjusted expenses as a percent of issues		6.4

A. BLACKBURN

A DOD STUDY OF MILITARY EXCHANGES

AAFES Distribution Issues/Costs
For Year Ending 22 Jan 1990

	CONUS	EUROPE	PACIFIC	TOTAL
Retail Issues (at sell)	2,668,000	773,261	209,405	3,650,666
Costing %	75.98%	73.59%	74.79%	75.40%
Retail Issues (at cost)	2,027,000	569,000	156,614	2,752,614
Food Issues	1,944	33,195	23,405	58,544
Expense Issues	22,224	11,040	4,392	37,656
Tranship Mdse	264,900	59,300	19,338	343,538
Total Issues	2,316,068	672,535	203,749	3,192,352
Distribution Expenses	144,262	62,114	12,081	218,457
Exp as Percent of Issues	6.23	9.24	5.93	6.84
Adjustments				
Cash Discounts	(22,110)	(2,560)	(931)	(25,601)
YAPS Cash Discounts *	0	0	(1,857)	(1857)
Distribution Allowances	(19,465)	0	0	(19,465)
Special Allowances	(7,755)	(1,766)	(861)	(10,382)
Volume Discount Remitted				(2,782)
Distribution Overhead				(14,200)
Adjusted Expenses				144,170
Adjusted Expenses as Percent of Issue				4.52%

* Yen Accts Payable Discounts: Purchases made in Japan for DCs in EUR and PAC. Mainly electronics mdse. Dollar amounts expressed as thousands.

Distribution Expenses for CONUS and EUR do not match the operating statements due to inter-account transfers before the financial statements are generated. Attached as Enclosures 1 and 2 are copies of pro formas prepared by the distribution accounting office. Total CONUS and EUR expenses of $144,262,000 and $62,114 on the pro formas match those shown on the above schedule.

Martin R. Handel
Comptroller

Signed Fax received July 24, 1990

A DOD STUDY OF MILITARY EXCHANGES

FY 89 AAFES DISTRIBUTION CENTER EXPENSES *

DC	M$	% TO ISSUES(AT RETAIL)
ATLANTA	29.2	4.42
FDC DALLAS	9.2	2.21
D.DANIEL	26.0	6.22
ADR	12.1	---
AUTOMOTIVE	.4	11.22
FDC ATLANTA	.4	1.14
DAYTON	4.4	9.13
FT WORTH	8.0	7.94
WACO	13.9	7.61
DENVER	1.1	6.83
NORTON	2.1	6.50
OAKLAND	19.4	4.62
PUGET SOUND	1.4	4.62
PANAMA	1.8	8.19
GIESSEN	38.4	6.12
GRUENSTADT	10.4	10.02
ITALY	7.4	29.30
SPAIN	.9	24.70
UK	1.3	5.21
TOTAL	199.4	5.79

* Several small facilities not listed, but included in total

SUMMARY OF CURRENT SYSTEMS

The existing distribution/transportation systems provide goods and services to the military exchange customers in a responsive and efficient manner based on each service's corporate philosophy of distribution... AAFES is centralized and primarily uses an organic fleet; NAVRESSO is decentralized and primarily employs common carrier... both use direct vendor delivery where economically feasible. The Marine Corps MWRSPTACT employs direct vendor delivery primarily as its distribution system. Given the above, let's consider several assumptions before addressing the feasibility of consolidating distribution systems.

ASSUMPTIONS

In this review, a 20 - 25% reduction in military strength over the next five years is projected based on Congressional and Department of Defense discussions as well as the Base Closure List, see Figure 5-4. For a consolidated distribution/transportation system to work, we would expect to have a common stock assortment provided by a central procurement system, a rapid reorder system in place and a landed-cost analysis completed to determine whether an item should be warehoused or delivered directly to the store. Furthermore, a common management information system is essential to permit the various exchange systems as they exist today to receive a comparable level of support.

Excluded from the consolidation issue, is fashion merchandise, as well as Navy Lodges, Ships Stores, Uniform Support Center and the Navy Clothing and Textile Research facility in Natick, Massachusetts. These programs operate independently of the existing NAVRESSO exchange distribution/transportation system and should continue to do so.

EVALUATION CRITERIA

The following evaluation criteria will be used to assess each alternative:

- Cost... per issue from distribution center operations
- Existing facilities... both the physical layout and whether capacity to expand exists
- Customer service ... How well are we servicing the customer? In stock percentage at store level and frequency of delivery to the stores are two measures.
- Supplier relationship... Is the supplier relationship long-term or short-term and how reliable?
- Technology... Do we have the information system technology to support a consolidated distribution system? What is the cost to acquire it?
- Pipeline... How extensive is it? How much inventory do we have in the pipeline? Can we reduce the inventory investment?

ALTERNATIVES

Three alternatives were considered after reviewing all options. They are: Status Quo - Partial Consolidation - Full Consolidation.

Status Quo

Under this alternative, the three military exchange systems would operate independently and pursue their own initiatives to improve efficiency given the changes expected in our exchange operations. Despite the downturn projected in troop strength, particularly overseas, all exchange systems have plans to streamline operations to include distribution centers.

AAFES intends to streamline the European support infrastructure and build a modern distribution center on the west coast. NAVRESSO is consolidating distribution centers in the Continental United States (CONUS) i.e., consolidate Mechanicsburg and Davisville NAVRESSOFSOs into NAVRESSOFSO Norfolk (this was approved in mid August 1990), consolidate Pensacola complex into NAVRESSOFSO Jacksonville and consolidate NAVRESSOFSO Oakland into NAVRESSOFSO Auburn. Both exchange systems are expanding their use of Electronic Data Interchange of information between vendor sources and locations to reduce the investment in inventory.

Partial Consolidation

Defined as central support to separate systems, this alternative provides common functional support systems to the three military exchange systems.

Distribution/transportation subsystem would provide a common infrastructure for all exchange systems along with a common stock assortment for the most part, management information and accounting.

Without these basic requirements, a consolidated distribution/ transportation subsystem would not function effectively.

Under this alternative, distribution center expenses would be allocated based on issues as in the case under both the AAFES and NAVRESSO distribution/ transportation subsystems currently.

Full Consolidation

Under full consolidation the principle savings will be in the CONUS locations. Overseas distribution/ transportation would remain unchanged except for those areas where the geographical proximity would permit the merging of overhead personnel. In these locations, the AAFES distribution overhead would be reduced and the NAVRESSO location would manage the two distribution centers. These locations are:

Hawaii	Italy
Guam	Japan
Subic Bay	Spain

Specific explanations of the recommended consolidated distribution centers follow on the next few pages.

Northeast

The distribution and transportation function, presently being performed by the Davisville (NAVRESSO), Mechanicsburg (NAVRESSO) and Norfolk (NAVRESSO) distribution centers, will be consolidated into the Dan Daniel Distribution Center (DDDC). The DDDC will incorporate into their daily operating schedule, all receiving, storage, issue and transportation activities which will maintain the service levels currently enjoyed by all activities serviced, may they be AAFES or NAVRESSO. The DDDC will provide support functions to the NAVRESSO activities by employing the current Warehouse Management System (WMS) just as it does for AAFES activities. NAVRESSO activities which will be supported by DDDC will employ data communications system for order and accounting compatible with the AAFES Management Information and WMS systems.

Building CD-1, which is the primary distribution center for the FSO Norfolk, should be retained for Navy Military Clothing Distribution activity which currently occupies a commercial facility. Building Z-105, the FSO Norfolk overseas vanstuffing activity should be returned to the base commander.

The below chart shows the current key indicators for each distribution center and the required data under a partial/full consolidated alternative. A similar comparison is shown for each consolidated distribution center on the next four pages.

DCs	SqFt (k)	Lines Whsd	$Issues Daily Ave	Cs Ship Daily Ave	# Fac Serv	$Inv Ave	Manpow
Davisville	100	6,900	82,000	2,700	61	2,589	75
Mechanicsburg	100	4,800	90,000	2,900	18	3,810	62
Norfolk	223	4,200	203,000	8,800	33	5,095	110
Dan Daniel	1,100	23,000	2,000,000	40,000	3,500	93,000	850
Total	1,523	38,900	2,375,000	54,400	3612	111,494	1097
Required	1,100	23,000	2,375,000	54,400	3612	107,880	974

Southeast

The distribution and transportation presently being performed by the Jacksonville (NAVRESSO), Memphis (NAVRESSO) and Pensacola (NAVRESSO) will be consolidated into the Atlanta Distribution Center (AAFES), Ft. Gillem, GA.

The Atlanta Distribution Center (ADC) will assimilate into the daily and routine operating schedule all distribution and transportation activities which will maintain the service levels currently enjoyed by all activities serviced today by NAVRESSO and or AAFES distribution. The ADC will provide support functions to the NAVRESSO, MCX activities employing the current Warehouse Logistics System (WLS) as applied by AAFES operations.

MCX and NAVRESSO activities which will be supported by ADC will employ the data systems/ communications for ordering and accounting compatible with the AAFES Management Information and WLS systems.

The distribution center at FSO Jacksonville will be phased out completely and the facility returned to the base commander. The facility at Naval Training Center (NTC) McCoy Annex (45,000 sq ft) should be assigned to NTC McCoy Annex. Buildings 523 and 135 at Naval Air Station (NAS) Jacksonville should be assigned to NAS Jacksonville Exchange.

DCs	SqFt (K)	Lines Daily Whsd	$Issues Daily Ave	Cs Ship Ave	#Fac Serv	$Inv Ave	Manpow
Jacksonville	100	7,100	208,000	9,600	56	6,886	139
Memphis	25	1,900	39,000	1,300	6	1,200	14
Pensacola	60	9,100	81,000	2,700	41	1,665	51
Atlanta	3,345	10,000	3,660,000	40,000	2,000	100,000	1,300
Total	3,530	28,600	3,988,000	5,310	2,104	92,751	1,504
Required	3,345	10,000	3,988,000	5,310	2,104	89,640	1,432

Central States

The NAVRESSO distribution and transportation functions presently performed by the independent exchange distribution/warehouses at NAS Dallas and NAS Corpus Christi will be consolidated into the Waco Distribution Center (AAFES), Waco, Texas.

The Waco DC will assimilate into their daily and routine operating schedules, all distribution and transportation activities which will maintain the service levels currently enjoyed by all activities today serviced by NAVRESSO and AAFES distribution.

The Waco DC will fold into and blend support functions to the NAVRESSO activities into the current Warehousing Management System (WMS) as applied by AAFES. NAVRESSO activities which will be supported by the Waco DC will employ the data system/communications for ordering and accounting compatible with the AAFES Management Information and WMS systems.

The distribution activities at NAS Dallas and NAS Corpus Christi will phase out entirely. The buildings should be assigned to the respective exchange.

DCs	SqFt (K)	Lines Whsd	$Issues Daily Ave	Cs Ship Daily Ave	#Fac Serv	$Inv Ave	Manpow
Dallas	15	11,000	30,000	1,000	4	1,100	14
Corpus Christi	40	3,600	33,000	1,100	8	1,100	14
Waco	500	13,000	1,000,000	25,000	454	45,000	526
Total	550	28,100	1,063,000	27,100	466	45,000	554
Required	500	13,000	1,063,000	27,100	466	47,100	537

Northwest

The AAFES Oakland DC will consolidate with the distribution and transportation function of the NAVRESSO Oakland and Auburn distribution centers. The AAFES Oakland DC will assimilate into its daily operating schedules, all distribution and transportation activities which will maintain the service level currently enjoyed by all activities today serviced by NAVRESSO or AAFES distribution.

The AAFES facility will assume control of the Oakland NAVRESSO building and provide support functions to NAVRESSO activities into the current Warehouse Logistics System (WLS). NAVRESSO activities which will be supported by Oakland will employ the data system/communications for ordering and accounting compatible with the AAFES Management Information and WLS systems.

The FSO Auburn DC should be assigned to the Seattle exchange or the base commander.

DCs	SqFt (K)	Lines Whsd	$Issues Daily Ave	Cs Ship Daily Ave	# Fac Serv	$Ave Inv	Manpow
Oakland(FSO)	360	7650	157,000	5200	58	3886	75
Oakland(AAFES)	1245	18,817	1,600,000	32,000	945	61,600	782
Auburn	100	6500	107,000	3,500	10	2,217	60
Total	1705	32,967	1,864,000	40,700	1013	67,703	917
Required	1605	18,817	1,864,000	40,700	1013	65,000	883

Southwest

Consolidation the San Diego (NAVRESSO) DC and Norton (AAFES) DC should be accomplished by 1993/4 time frame. The urgency is due to the closure of Norton Air Force Base on which the DC is located. AAFES must vacate the premises by 1993. Air Force appropriated funds of $4.85 million have been set aside to build a replacement facility. The consolidation of the San Diego and Norton facilities will realize greater economies as well as enhanced service levels to all exchange facilities currently serviced.

Two alternatives must be explored. One is to expand and improve the facility in San Diego or build a new facility at an optimum site (if building improvement of the San Diego activity is not feasible). Marine Corps exchange locations are on the west coast will receive support from the new consolidated distribution center.

DCs	SqFt (K)	Lines Whsd	$Issue Daily Ave	Cs Ship Daily Ave	#Fac Serv	$Inv Ave	Manpow
San Diego	166	9,200	326,000	10,800	76	5,122	199
Norton	129	3,900	104,000	3,500	107	4,400	93
Total	295	13,100	430,000	14,300	183	9,522	292
Required	250	9,200	430,000	14,300	183	7,402	219

ASSESSMENT OF FULL CONSOLIDATION

There will be several exchange operations that will retain their distribution centers physical plant, and will have to modify their operations for a common support infrastructure, i.e., information systems, central procurement, and physical distribution process.

Productivity

Since there is no common productivity measurement employed within NAVRESSO and AAFES, no comparisons of productivity within the distribution centers was possible. Furthermore, with the wide disparity of capital facilities, i.e., from fully automated to totally manual warehouses with multiple buildings, cost per issue became our baseline comparison. As stated previously, that difference is $.009/issue.

Labor Savings

Without an accurate measure of productivity in cases, or total issues in dollars, a projection for saving direct labor was invalid. Therefore, labor savings were addressed without regards for whether it is direct or indirect. Labor cost estimate of $21,000 including fringe benefits was used.

Future Savings - Southwest

The NAVRESSOFSO San Diego distribution center is unable to support Norton AFB and the west coast Marine Corps exchanges. Since Norton AFB is projected to close within the next three years, the Services must conduct a separate analysis to determine where a new or expanded distribution center should be located. For the NAVRESSO facility to expand and serve all other service exchanges, i.e., Norton and Marine Corps (west coast), the collocated commissary distribution center may be affected...requiring another variable.

In summary, we should defer consolidation of the San Diego, Norton, and Marine Corps exchanges until these issues are resolved. AAFES has deferred a major capital investment in a new automated distribution center to support Norton pending the results of this study.

EVALUATION OF ALTERNATIVES

Status Quo

Using evaluation criteria discussed, there is minimal disruption or turmoil under status quo.

Cost - The current cost per issue (at cost) of the distribution/ transportation system as stated is:

AAFES	6.4%
NAVRESSO	5.5%
MWRSPTACT	varies

Facilities -- While there are differences in physical layout and age of these capital facilities, AAFES has invested in more modern state of the art distribution centers in Waco, Texas and Newport News, Virginia. Although NAVRESSO has less modern facilities it does plan to consolidate several distribution centers to improve efficiency. Marine Corps MWR distribution/ transportation is unique to each base; at some locations, like Henderson Hall, vendors perform the distribution function whereas at other exchanges, such as Camp Lejuene, the exchange moves merchandise between sales locations at that complex.

Customer Service - From the customer vantage point, the status quo will deliver the same level of support to customers, stores and patrons.

Supplier - Suppliers would see the same relationship continue... business as usual.

Technology - Technology remains constant under this alternative with the exception of the current strategies all service exchange systems have to improve their Management Information System.

Pipline - Remains constant except for current initiatives. In summary, this alternative permits each military exchange system to address the business uncertainty independently with the least turmoil and disruption to customers and suppliers.

EVALUATION OF ALTERNATIVES

PARTIAL/FULL CONSOLIDATION

Cost - Distribution center expenses under this alternative, would be allocated to the customers, i.e., exchanges, based on issue. If all current NAVRESSO issues and an estimate for MWRSPTACT issues flow through the new distribution system, here is a summary of the cost analysis given no additional economies in purchasing power or efficiency of personnel:

Current Distribution Expenses ($M)

	Cost	Issues	%
AAFES	204.3	3,192.4	6.4
NAVRESSO	29.7	543.2	5.5
TOTAL	234.0	3,735.6	

Partial/Full Consolidation Estimate

Projected Cost ($M)		Projected Issues ($M)	
204.3			
(.8)	AAFES Current Overhead	3192.4	AAFES
15.8	Distribution Centers Remaining	543.2	NAVRESSO
9.1	Additional labor	100.0	MWRSPTACT
4.5	Transportation		
233.7	Total	3,835.6	Total
			= 6.1%

Any increased distribution center expenses would be passed on to the customer if we did not realize any increased efficiencies. Although we expect overhead savings in this consolidation effort, primarily NAVRESSO and MWRSPTACT employees, but we can expect to spend about $15.9 million in one-time costs to achieve these savings. These personnel and equipment costs which exclude the management information system one-time costs noted in Chapter 6, are listed in Figure 5-5.

Supplier - The larger suppliers will probably benefit under a partial or full consolidation scenario. See Chapter 4 for a complete assessment of this element.

Technology - Information system plays an integral role in this alternative as it does under full consolidation. See Chapter 6 for a complete assessment of this element...including the investment required.

Pipeline - An increased pipeline may result from partial or full consolidation given the longer outbound transportation network. However, vendor inbound routes will be reduced.

Facilities - The existing CONUS distribution centers for AAFES have the capacity to support the commodities currently stocked at NAVRESSO distribution centers, provided a common stock assortment exists, for the most part, i.e., expanding depth of the range carried within the existing AAFES distribution centers. The capacity does not exist to add completely separate stock assortment for NAVRESSO and MWRSPTACT. Although Atlanta and Oakland are older facilities, but they do have the capacity to support the other service exchanges within their geographical area as described in this and the full consolidation alternative.

Customer Service - During the transition period, there may be some disruption to the level of customer service despite our concern for equal to or better than the current level of customer service (one of our objectives). Thus, partial consolidation for distribution/ transportation subsystem will be the same under the full alternative. See Chapter 7 for a more complete assessment of this element.

SUMMARY

The near term annual savings of $4.6 million under the full or partial consolidation alternatives will become $9.7 million when the southwest distribution center issue is resolved. Appropriated fund support, its location and the scope of the project are areas of uncertainty. While AAFES plans to invest in a modern mechanized distribution center to replace the facility at Norton AFB given the base closure plan, the current project scope is a 130,000 square floor facility designed to handle existing AAFES throughput. The estimated cost of this facility is $9.6 million, $4.85 million of which should come from an Air Force base closure appropriation. The 100,000 square floor NAVRESSOFSO San Diego distribution center could be expanded if the existing commissary operation vacated the contiguous warehouse space. If a new 250,000 square foot distribution center were built the estimated cost is $18.5 million. Neither can support the consolidated exchange sales base without expansion.

Savings from consolidating the distribution/transportation subsystem will be achieved in the long term. The savings will come predominantly from distribution centers within CONUS since that is where the majority of the costs for both NAVRESSO and AAFES exists. (see Figure 5-6) One time costs which include the construction cost of a new distribution center amount to $15.9 million. Beyond the estimated savings, we would expect to achieve other operational efficiencies.

The larger distribution center concept will bring with it a need for flexibility...a management opportunity for the downsizing of our troop strength in the future. A summary of the savings expected from the consolidated distribution/transportation subsytem follows and is also in Figure 5-7. It deletes the NAVRESSO and Marine Corps exchange distribution/transportation function and then adds back those distribution centers/personnel which would remain. To accomodate the additional workload, we have added back some direct labor and outbound transportation costs, using either organic or common carrier rates in the calculation. Since the consolidated distribution center will be further from the supported Navy and Marine Corps exchanges in most cases, the outbound transportation costs will increase. We have not calculated a net cost of outbound transportation for the Marine Corps given that their distribution/transportation expense is currently for the most part in their cost of goods. Inbound transportation costs will be less given that the vendors are closer to the distribution center. See Figure 5-8 for the specific rationale to our estimate.

Figure 5-9 reflects the relationship of total distribution/transportation subsystem costs. Determining the optimum solution is the objective. Although it is difficult to determine where the exchange systems are on the curve, the important point is to understand the relationship between the interdependent variables.

Distribution/Transportation Summary For Partial/Full Consolidation (M$)

		COST	SAVINGS
FY 89 NAVRESSO		29.7	
FY 89 MCX (less MWR)		3.5	
			33.2
AAFES Overhead Overseas			.8
			34.0
Add Back:			
Remain the same			
San Diego*	4.22		
MCX (West Coast)*	1.76		
FDC	2.34		
Pearl	2.72		
Great Lakes	1.07		
Subic	1.22		
Yoko	1.87		
UK	.61		
		15.8	
Additional Direct Labor			
NE	124		
SE	132		
NW	101		
SC	11		
MCX	63		
	431 X .021 M	9.1	
Transportation **			
+ Outbound		4.5	
NAVRESSO	5.1		
MCX	1.3		
- Inbound			
NAVRESSO	(1.4)		
MCX	(.5)		
TOTAL SAVINGS (Near Term)			4.6
FUTURE SAVINGS			
			5.1
San Diego *	4.22		
MCX (West Coast)*	2.20		
Additional Direct Labor		1.3	

** Estimated

Figure 5-7

RECOMMENDATION SUMMARY

5 - 1 Consolidate most NAVRESSO distribution centers within CONUS into existing AAFES facilities using common management information system and stock assortment. Support MCX east coast and downrange exchanges from Newport News and Atlanta... annual savings $3.8 million.

5 - 2 Reduce AAFES overhead staff at several overseas distribution centers to improve efficiency with other services' distribution centers... annual savings $.8 million.

5 - 3 Consolidate Norton AFB replacement facility ($9.6 Million) in FY 93/94 with NAVRESSOFSO San Diego distribution center at a cost-effective location and/or modified existing distribution center in San Diego. (Assumes Air Force appropriated fund support of $4.8 million)... future annual savings $4.2 million.

5 - 4 Consolidate distribution/ transportation support for MCX west coast and related Pacific area exchanges when Norton - San Diego issue is resolved... future annual savings $.9 million.

FIGURES

Navy Exchange Distribution Centers

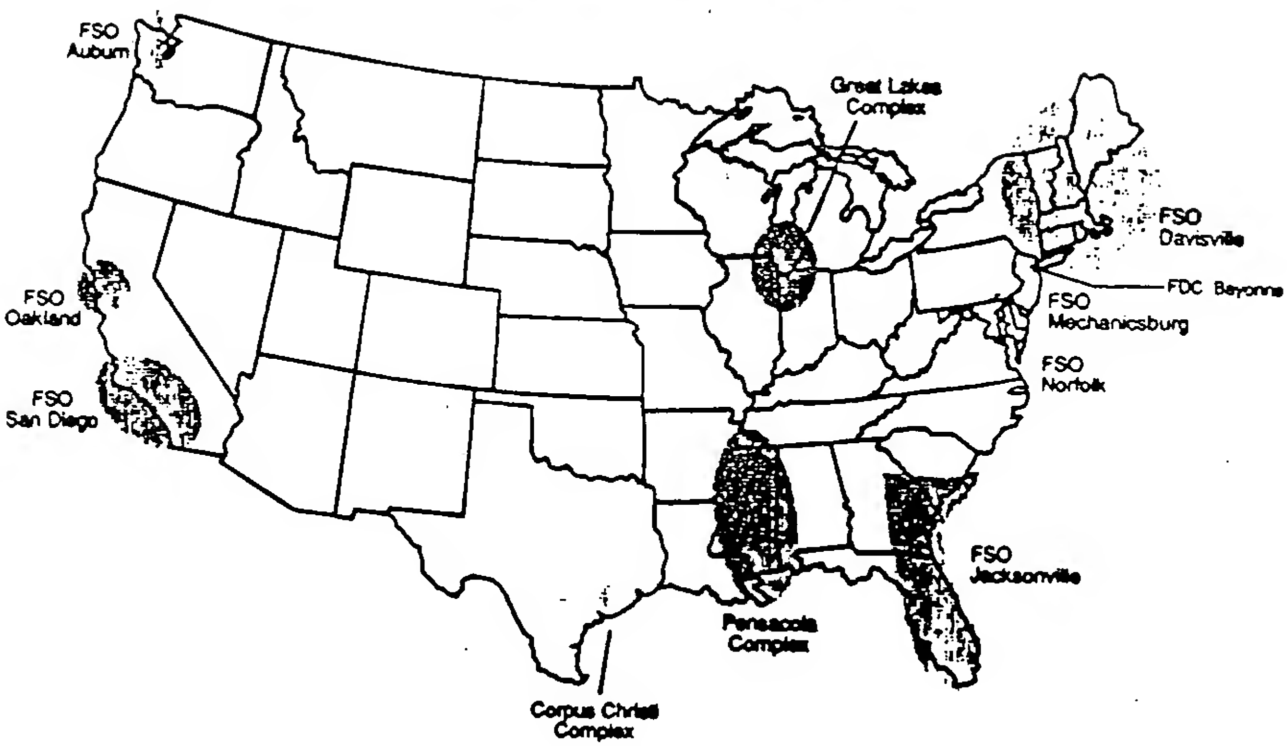
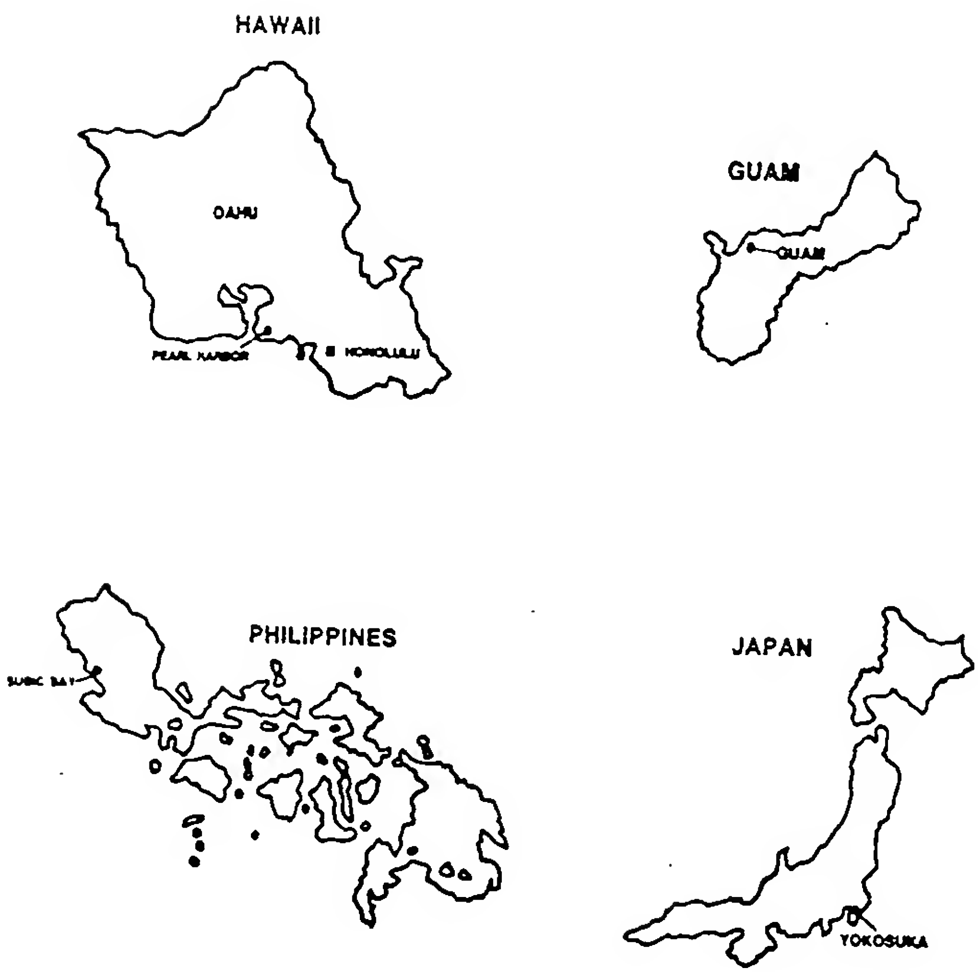


Figure 5-1

European Navy Exchange Distribution Centers

Pacific Navy Exchange Distribution Centers



AAFES DISTRIBUTION CENTER SUPPORT IN CONUS

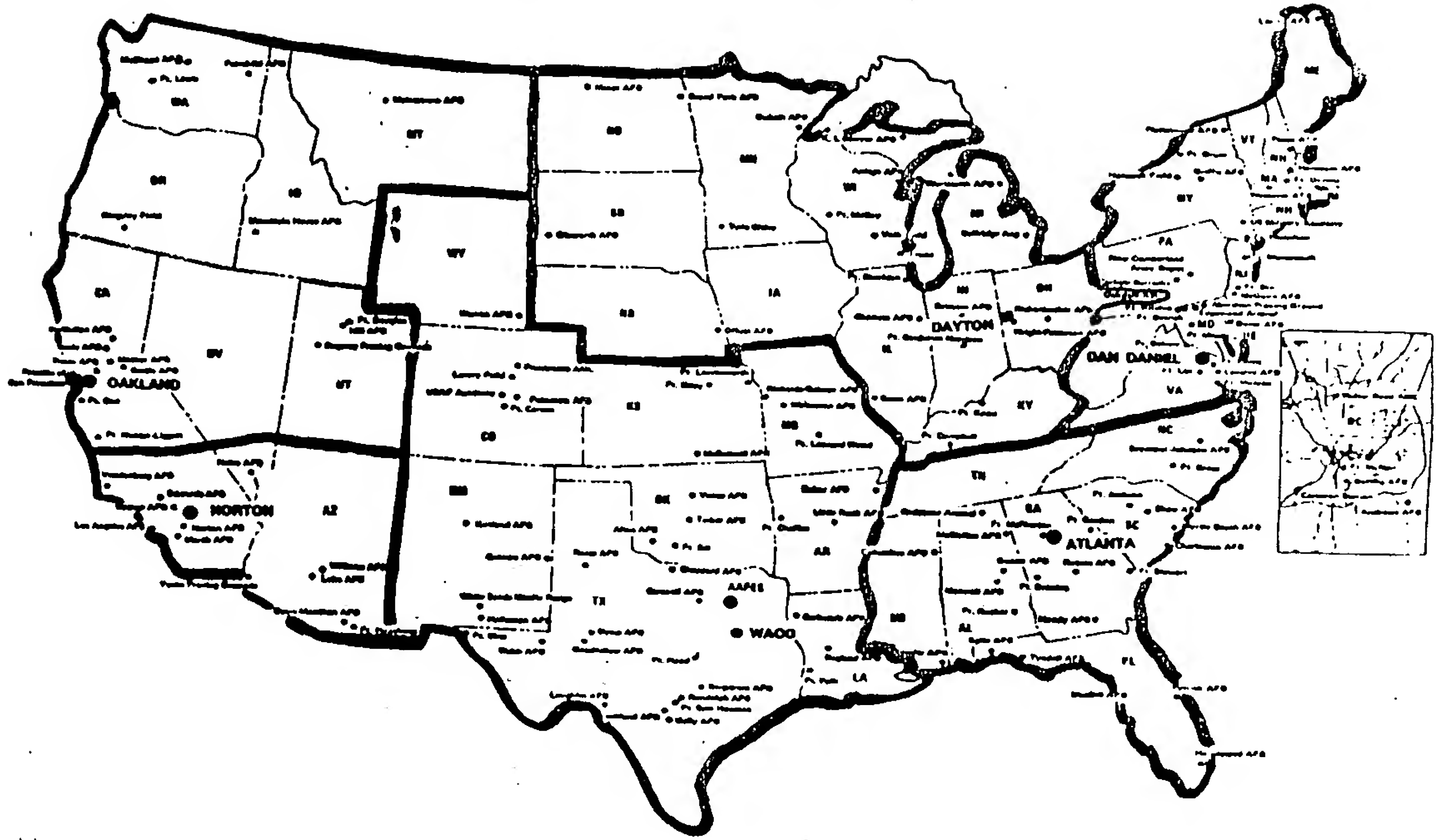
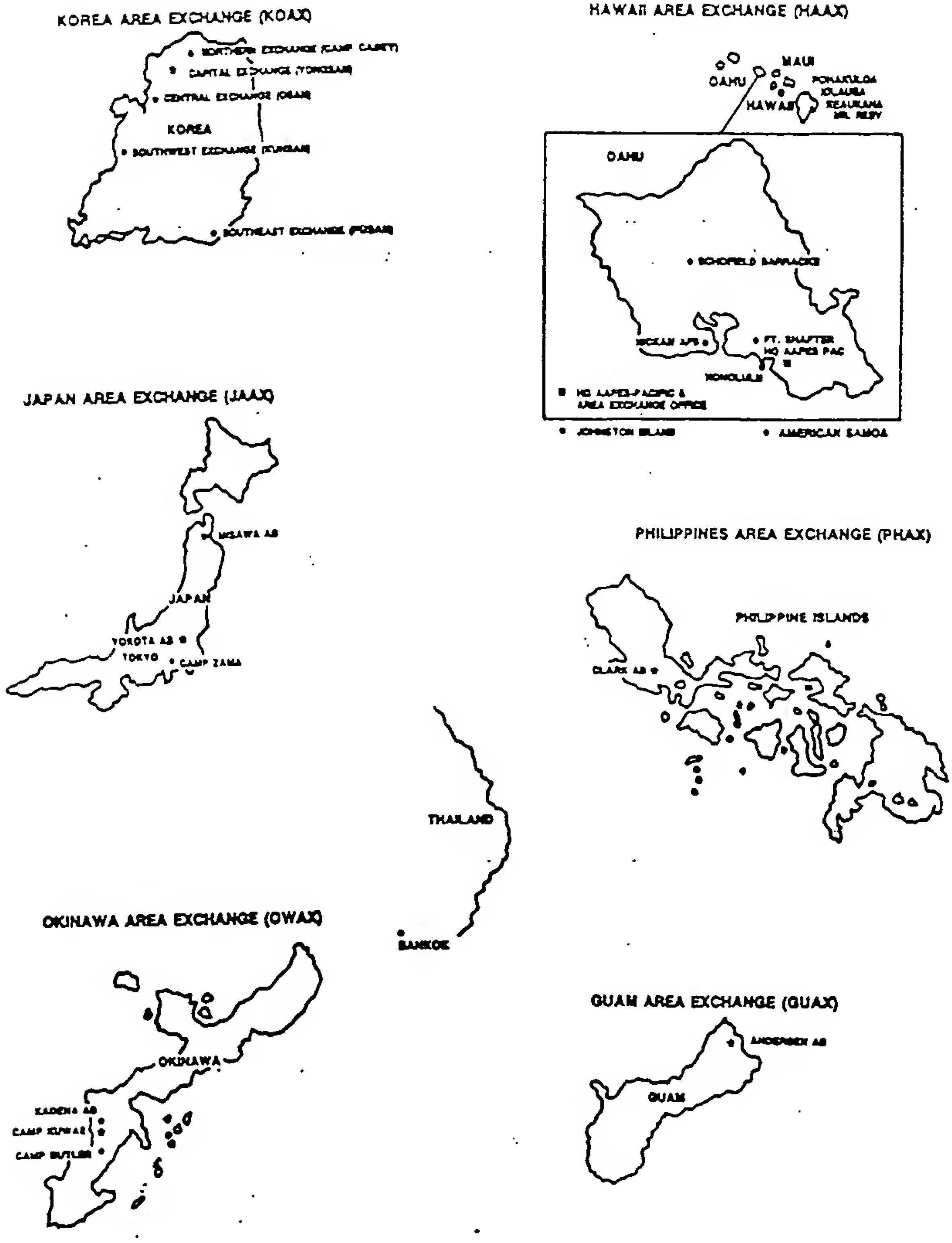


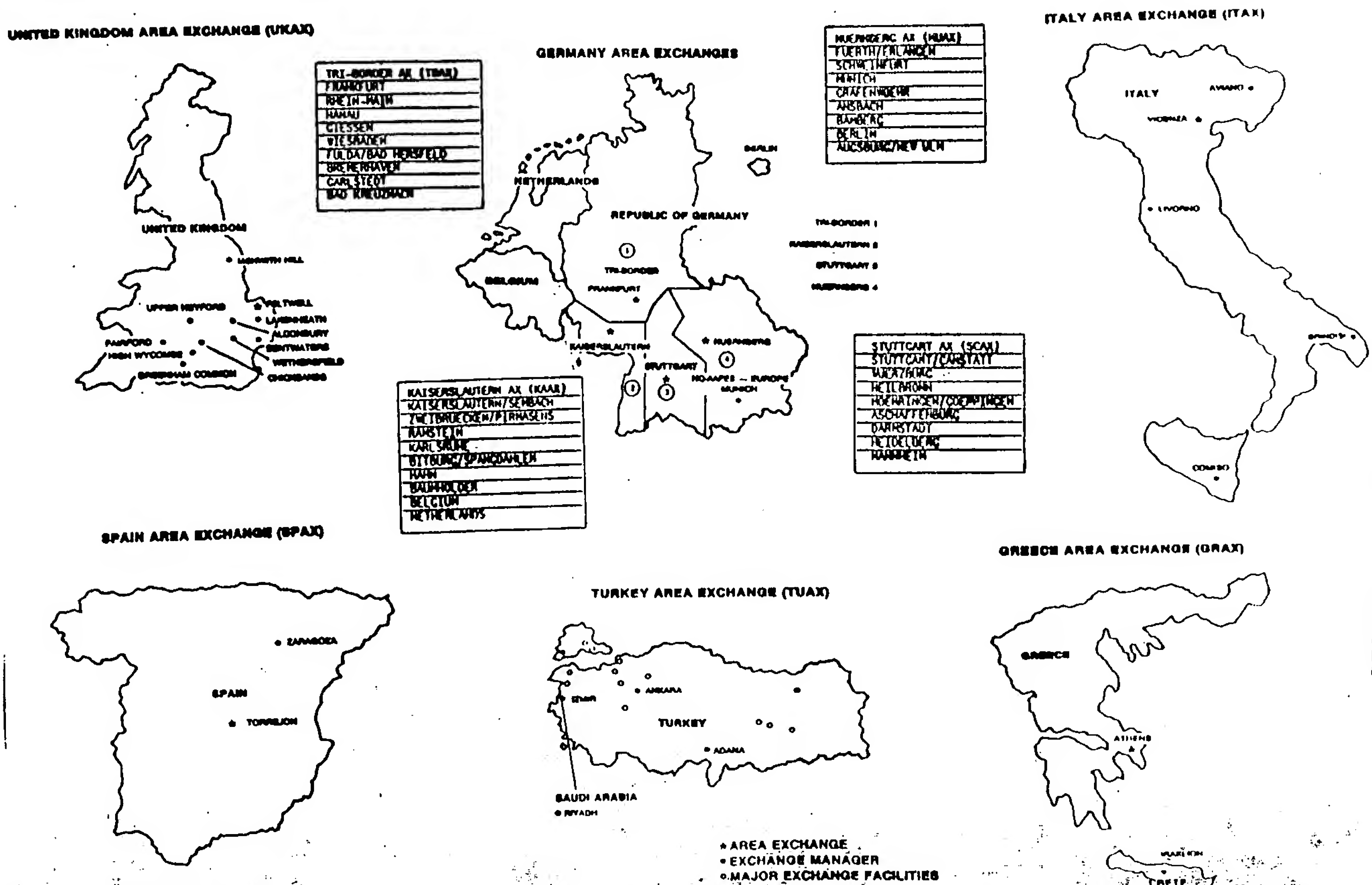
Figure 5-2

AAFES-PACIFIC



★ Area Exchange Office

AAFES-EUROPE



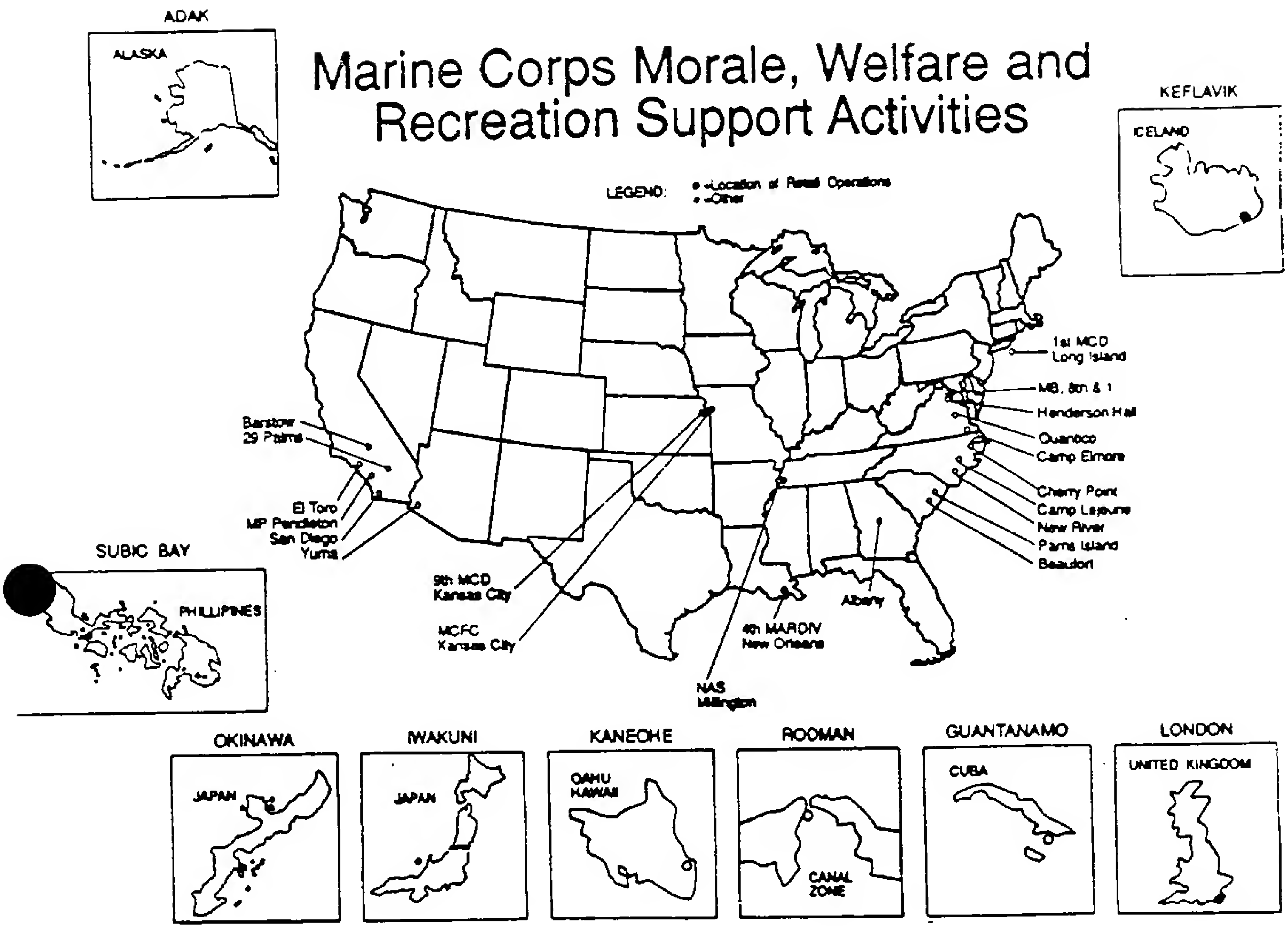

Marine Corps Morale, Welfare and Recreation Support Activities
LEGEND:
=Location of Retail Operations
=Other
ADAK
ALASKA
KEFLAVIK
ICELAND
1st MCD Long Island
MB, 8th & 1
Henderson Hall
Quantico
Camp Elmore
Cherry Point
Camp Lejeune
New River
Parris Island
Beaufort
Barstow
29 Palms
El Toro
MP Pendleton
San Diego
Yuma
9th MCD Kansas City
MCFC Kansas City
4th MARDIV New Orleans
NAS Millington
Albany
SUBIC BAY
PHILLIPINES
OKINAWA
JAPAN
IWAKUNI
JAPAN
KANEOHE
OAHU HAWAII
RODMAN
CANAL ZONE
GUANTANAMO
CUBA
LONDON
UNITED KINGDOM

Figure 5-3

AIR FORCE BASE REALIGNMENT AND CLOSURE

INSTALLATION	START - STOP (MILITARY FYs)		MILITARY MANPOWER GAINS (LOSSES)	
Anderson AFB, Guam++		90/4		(909)
Bangor AFB, ME		92/4		(340)
Beale AFB, CA	93/3		1,655	
RAF Bentwaters, UK**	90/4			(556)
Bergstrom AFB, TX**		93/4		(4,606)
Cannon AFB, NM		91/4	1,057	
Chanute AFB, IL*	90/2	93/4		(6,000)
Comiso AS, Italy**		91/4		(1,900)
Eaker AFB, AR**		93/4		(2,981)
Eglin AFB, FL++	91/1			(504)
Erhac, Turkey**		91/4		(52)
Eskisehir, Turkey**		91/4		(53)
RAF Fairford, UK**		91/4		(1,095)
George AFB, CA*	92/1	93/4		(5,200)
Goodfellow AFB, TX		93/4	791	
RAF Greenham Common, UK**		91/4		(2,600)
Hellenikon AB, Greece**	91/1	91/4		(1,323)
Holloman AFB, NM		92/4	1,164	
Kwang-Ju AB, ROK**		91/4		(402)
Keesler AFB, MS		93/4	715	
Los Angeles AFB, CA**		94/4		(2,109)
Lowry AFB, CO	93/4		1,140	
Luke AFB, AZ++	91/1	91/4		(647)
Mather AFB, CA*		93/4		(6,000)
McChord AFB, WA	90/2		530	
Mt. Home AFB, ID	92/1	93/4	1,903	
Myrtle Beach AFB, SC**		93/4		(3,293)
Norton AFB, CA*		93/4		(6,800)
Osan AB, ROK		92/4	494	
Pease AFB, NHe	90/1	91/4		(3,250)
Sheppard AFB, TX		93/4	2,583	
Suwon AB, ROK**	92/2	93/4		(835)
Taegu AB, ROK**	91/1	92/4		(1,281)
Tonapah AFS, NV++	92/3			(1,958)
RAF Wethersfield, UK**	91/1	91/4		(513)
Wright-Patterson AFB, OH++	91/1			(592)
Zweibrucken AB, FRG**		93/4		(4,200)

Closures - Navy

Navy Station New York (Brooklyn)*
Navy Station Puget Sound (Sand Point) Washington*
Navy Hospital Philadelphia

* Closure actions per Public Law 100 - 526
** Close per SECDEF decision
\+ Partial closure PL 100-526
++ Partial closure per SECDEF decision
e Limited exchange

Figure 5-4

ARMY POST REALIGNMENT AND CLOSURE

INSTALLATION	START - (MILITARY	STOP FYs)	MILITARY MANPOWER GAINS	(LOSSES)
Cameron Station, VA*		95		(337)
Fort Belvoir, VA		93/3	3,606	
Fort Ben Harrison, I			1,309	
Fort Carson, CO			700	
Fort Devens, MA			1,420	
Fort Dix, NJ+		93/4		(4,656)
Fort Douglas, UTe	91/2	95/3		
Fort Gillem, GA++				(526)
Fort Hood, TX++	90	91		(12,204)
Fort Huachuca, AZ++	91	94		(616)
Fort Jackson, SC			787	
Fort Knox, KY++	90	94		(3,010)
Fort Lewis, WA++	90	91		(7,892)
Fort McClellan, AL**		93		(2,691)
Fort Meade, MD++				(510)
Fort Myer, VA		93/2		N/A
Fort Ord, CA**	92	93		(14,849)
Fort Sheridan, ILe		94/2		(1,383)
Kapalama, HI*	91/2	93		N/A
Presidio of SF, CA*	95/1			(2,218)

Implementation Costs for Distribution Center Amalgamation Summary (K$)

Unamortized Projects/Depreciation		
NAVRESSO		4609
MWRSPTACT		100
Total		4709
Personnel		
NAVRESSO	1133	2130
MWRSPTACT	254	
AAFES	743	
Training		
Dist Center	See Chapter 6	150
Store		
Conversion to AAFES System	See Chapter 6	
Total		6,989

Southwest Distribution Center

$18,500	for 250,000 SF (required scope)
- 9,600	for 130,000 SF (current scope)*
$ 8,900	

Total $15,889

* $4,850 from Air Force base closure funds

Figure 5-5

Implementation For Distribution Center
Amalgamation (K$)

NAVRESSO Depreciation Expenses * (as of May/Jun 90)		
Equipment (50% book value)	1,377	
Buildings (no salvage value)	189	
Unamortized Projects	3,043	
MWRSPTACT Depreciation Expense	100	
Total		4,709

* Write-off assets and extraordinary items

Early Retirement/RIF/Relocation/(FTE)

Direct	Total	20% Early Retirement *	RIF	Relocate
NAVRESSO	270	54	216	
MWRSPTACT	21	4	17	
Total	291	58	233	
Indirect				
NAVRESSO	49	10	39	
MWRSPTACT	21	4	17	
AAFES	36	7		29
Total	124	21	56	29
Grand Total	397	79	289	29

* 200 hrs lump sum leave

Figure 5-5 (cont)

RIF/Lump Sum Leave/Relocation (Cost K$)

Direct ($10/hr)	RIF (160 hrs)	Lump Sum Leave	Relocate	Total
NAVRESSO	315	78		393
MWRSPTACT	101	26		127
Indirect ($13/hr)				
NAVRESSO	102	26		128
MWRSPTACT	35	10		45
AAFES	---	18	725	743
Total	553	158	705	1436
Unemployment ($2.4K)				
NAVRESSO	612	--	--	612
MWRSPTACT	82			82
Training Distribution Center (8 hrs/new employee)				150
Store x locations x 8 hrs x # people			See Chapter 6	
Conversion to AAFES system			See Chapter 6	
Total				2280

Figure 5-5 (cont)

Training Cost Estimate

Initial start up training cost for associates amalgamated into the Distribution Center.

Location	# Positions to be Trained	
Northwest	96	
Northeast	119	
Great Lakes	70	
Southeast	116	
Central	16	
Southern California	147	
Italy	60	
Spain	37	
UK	27	
Puerto Rico	24	
Guantanamo Bay	14	
Bermuda	13	
Iceland	--	
Japan	49	
Philipines	79	
Hawaii	41	
Guam	25	
Marine Exchanges	178	
	1171	
	X 8	Training Hrs
	9368	Total Trng Hrs
	X $ 10	Cost per Trng Hrs
	93,680	
Productivity Loss	X 1.50	
	$140,520	Net Trng Cost

Figure 5-5 (cont)

Distribution/Transportation
Summary of Personnel Savings

Distribution Center	MCX*	CURRENT NAVRESSO	AAFES	TOTAL	PROPOSED	SAVINGS
NE		247	850	1097	974	123
	84			84	63	21
SE		204	1300	1504	1432	72
SC		28	526	554	537	17
NW	---	135	782	917	883	34
Total	84	614	3458	4156	3889	
NEAR TERM SAVINGS						267
SW		199	93	292	219	73
	84			84	63	21
TOTAL	168	813	3551	4532	4171	
FUTURE SAVINGS						94

* Based on $21K avg labor cost

Figure 5-6

Distribution/Transportation
Summary Savings

CONUS Distribution Center	New Location	Savings Personnel	Savings $ (M)
Davisville Mechanicsburg Norfolk Newport News (AAFES)	Newport News	123	2.583
Marine Corps (East Coast)		21	.441
Jacksonville Memphis Pensacola Atlanta (AAFES)	Atlanta	72	1.512
Dallas Corpus Christi Waco (AAFES)	Waco	17	.357
Oakland (AAFES) Oakland (NAVRESSO) Auburn	Oakland	34	.714
San Diego Norton	San Diego/* Los Angeles	73	1.533
Marine Corps (WCoast)	Area	21	.441

* Location and savings are predicated on a future study and investment of funds for a new or improved facility.

OVERSEAS

Subic Bay, PI (NAVRESSO) Clark, PI (AAFES)	Subic	6	.126
Pearl Harbor, HI (NAVRESSO) Kaplama, HI (AAFES)	Pearl	6	.126
Guam (NAVRESSO) Guam (AAFES)	Guam	6	.126
Naples, IT (NAVRESSO) Leghorn, IT (AAFES)	Naples	6	.126
Rota, SP (NAVRESSO) Torrejon, SP (AAFES)	Rota	6	.126
Yokosuka, JA (NAVRESO) Yokota, JA (AAFES)	Yokosuka	6	.126

Figure 5-6 (cont)

Distribution/Transportation Summary
For Partial/Full Consolidation (M$)

		COST	SAVINGS
FY 89 NAVRESSO		29.7	
FY 89 MCX (less MWR)		3.5	33.2
AAFES Overhead Overseas			.8
			34.0
Add Back: Remain the same			
San Diego*	4.22		
MCX (West Coast)*	1.76		
FDC	2.34		
Pearl	2.72		
Great Lakes	1.07		
Subic	1.22		
Yoko	1.87		
UK	.61		
		15.8	
Additional Direct Labor			
NE	124		
SE	132		
NW	101		
SC	11		
MCX	63		
	431 X .021 M	9.1	
Transportation **			
+ Outbound		4.5	
NAVRESSO	5.1		
MCX	1.3		
- Inbound			
NAVRESSO	(1.4)		
MCX	(.5)		
TOTAL SAVINGS (Near Term)			4.6
FUTURE SAVINGS			5.1
San Diego *	4.22		
MCX (West Coast)*	2.20		
Additional Direct Labor		1.3	

** Estimated

7 Sept 90

Figure 5-7

Inbound Transportation Analysis

The logic for calculating commercial transportation cost for the inbound portion is based on actual inbound transportation bills paid for collect freight (FOB origin). This volume represents approximately 40% of the total volume for AAFES and NAVRESSO. The freight charges represent approximately 2% of total dollar value of freight received via FOB origin.

For example, NAVRESSOFSO Jacksonville's FY 89 Data were:

Inbound Freight Collect Cost = $.48 M

Issues (Receipts) = $57.5 M

X 40% = 23.0 M

Inbound Freight Collect Cost/Issue

= .48/23

= 2%

For prepaid freight (FOB destination), the methodology as recommended by the Council of Logistics Management (Professional Development Course) was used.

This methodology, which was verified by samplings of actual freight, shows that freight costs (incorporated within the cost of goods) ranges from 2% to 3%. Further, the percentage range of 2% to 3% of the receipt value of goods received was matched against NAVRESSOFSO Jacksonville, Davisville and San Diego, which substantiates the 2% inbound transportation costs to deliver goods to the distribution centers from vendors.

Also, AAFES Distribution Headquarters Transportation Branch rated one day's freight bills from vendors to the Jacksonville DC, Pensacola DC, Davisville DC, Atlanta DC and Dan Daniel DC. The rating compared rates separately to individual DC to determine audited freight costs. Then the freight, from the various vendors, was rated in a consolidated move to the consolidated DC to determine freight cost.

The difference of the two separate rates was matched with the cost for a consolidated shipment.

Hypothetical Example

Vendor "A" weight X rate to Jacksonville
Vendor "A" 15 X weight X rate to Atlanta
Consolidated Mode:
Vendor "A" 16 X weight X Z rate to Atlanta

The result of the one-day sampling plus an analysis of published freight rate on file resulted in the following conclusions:

o Jacksonville and Pensacola distribution centers freight consolidated with the Atlanta DC achieved a reduction of 76.5% (comparing today's costs to consolidated shipments)

o Consolidated freight cost of Davisville and Mechanicsburg inbound freight with Dan Daniel freight achieved a reduciton of 64.3%

Since no freight costs are available for Marine Corps exchanges we have used 2% of the $50 million in freight we expect to pass through the consolidated east coast distribution center as the estimate of inbound freight costs.

Further, we have estimated the savings to be 50% of the estimated inbound freight costs, or $.5 million. Likewise, we have estimated the inbound savings for NAVRESSO freight to be 50% of the current inbound freight costs, or $1.4 million. While these are preliminary estimates, a more thorough analysis of the inbound savings cost is required, given vendor locations and actual volumes of freight.

A DOD STUDY OF MILITARY EXCHANGES

COST IMPACT OF WAREHOUSE SYSTEM

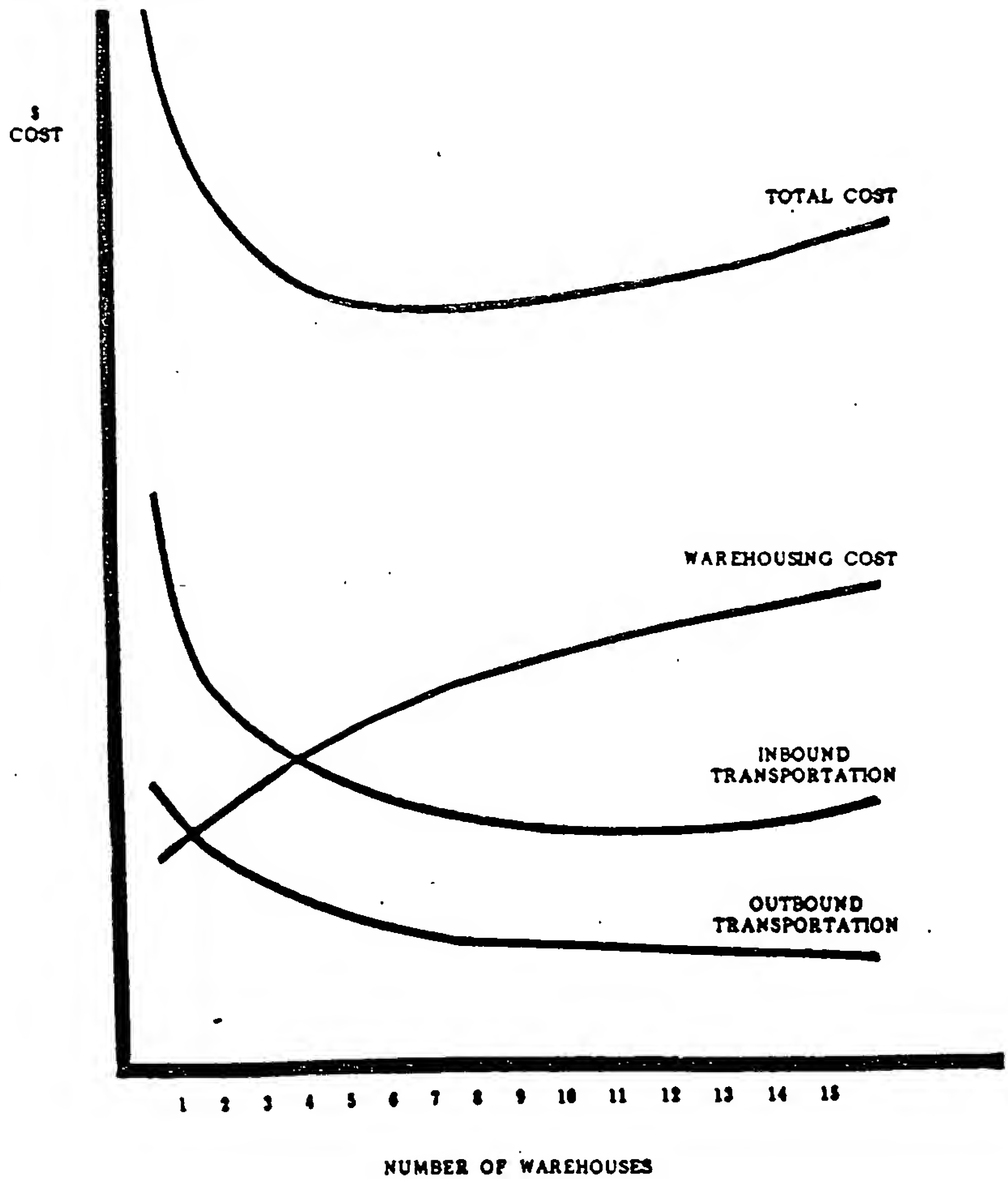


Figure 5-9

Source: Kearney: Management Consultants, AAFES Logistics Strategy: Final Report, July 1982

CHAPTER 6

MANAGEMENT INFORMATION SYSTEMS

OVERVIEW

Each military exchange service must have a viable Management Information System (MIS) organization and capability to meet today's information requirements. MIS must provide accurate and timely information to the location where business is being done and to the people who are planning the business strategies and tactics of tomorrow. Although technology improvements continue to become economically available at a geometric rate, MIS must insure that this technology is used efficiently and properly. Exchange service MIS organizations must maintain: (1) merchandise and business accountability; (2) security and data processing continuity while meeting the increasing retail competition and declining customer sales base.

RETAIL MIS DIRECTIONS

For a multitude of reasons, the retail world is rapidly evolving and competition for the customer is increasing. There is the demise of mass marketing driving the need to know more about our individual customers and his/her neighborhood market. Shopping habits are changing, customer service doesn't seem to have improved, off-price and factory outlets are making heavy inroads. These factors and others are increasing the competition tremendously at the local level. No longer can middle management at a regional or remote location make the necessary tactical decisions regarding stock assortments, category mix and pricing of goods to meet the local competitive area.

In today's retail world, stores must alter their way of marketing in order to survive, which will require improved sales to provide an adequate return on investment of capital. Less than half of the top 20 discount department stores in 1980 remain in business today. The two giants, Wal-Mart and K-Mart account for two-thirds of total sales. It seems that the top performers are making the

correct long term strategic plans to incorporate technology throughout every level of their entire organization. Even the management structures that proved so well in the last several decades are going through an evolution.

Successful retail companies are building their long range MIS plans around and into their long term strategic business plans. Corporate planning and decision making is using a variety of automated tools and methodologies.

Today's telecommunications can distribute information from the store upward and share corporate plans and information downward. This will allow middle management to be reduced or eliminated where determined to be desirable. Top performing organizations today are flat. Tactical decision making is more decentralized down to the store where local competition requires quick decisions by the store manager. Corporate planning and philosophy can be shared with the stores, distribution centers and offices via video conferences.

Stores must be efficient. Technology provides the ways and means to accomplish efficiency while at the same time maintaining control. More store functions are automated or planned for automation than ever before.

STRATEGIC USE OF TECHNOLOGY BY MAJOR RETAILERS

Table 6-1 shows the available technologies that are currently being used and/or being installed by industry leaders to continue as competitive operations and improve efficiency.

TABLE 6-1 MAJOR RETAILERS-INSTALLED/PLANNED TECHNOLOGY

EXCHANGE SERVICES - INSTALLED/PLANNED TECHNOLOGY

At Table 6-2 is the current and planned use of technology by the exchange services.

EXCHANGE SERVICES BASELINE POSTURE AND MODERNIZATION PLANS

The management information systems used for business operations and management control of the three exchange systems differ significantly in equipment, operating system software and business applications software. The major components of these systems are not compatible with the major components of any of the other systems as they stand today. There is no commonality which could be exploited today for elimination of duplicate effort.

All three services are in the process of replacing or significantly upgrading their MIS systems with modern technology and applications systems. There is a significant difference in the method each service has chosen to accomplish their goal.

AAFES BASELINE POSTURE AND MODERNIZATION PLANS (Refer to Attachment 1, Appendix C, for details)

AAFES has state of the art Amdahl mainframe computers and IBM operating systems that are positioned well for upgrades in memory and processing power. The AAFES worldwide telecommunications network is being further enhanced in CONUS by installation of a satellite network. This network upgrade is virtually complete.

Applications systems vary greatly. Some have recently been developed with the latest techniques, others are only a year or two old, while others are over 10 years old. They're getting the job done, however maintenance for some of the older systems is becoming increasingly more difficult and time consuming.

To replace the older systems and to provide stores with the automation efficiencies required in today's competitive world, several major projects have been initiated under the AAFES Systems Vision. The AAFES Store Automation Program (ASAP) will place computers at store level to mechanize manual functions and provide a platform for all future military base automation efforts. The mainframe computers and communications network make a wide variety of automated user tools available in today's stores and offices.

EPOS (Electronic Point Of Sale) back office processors are old and out of production. Software requirements are being readied for solicitation and, upon conclusion, hardware requirements will be finalized. Current planning projects retention of the present cash registers and scanners based on their current condition and maintenance experience.

NAVRESSO BASELINE POSTURE AND MODERNIZATION PLAN (Refer to Attachment 2, Appendix C, for details on the baseline.)

NAVRESSO has both Burroughs and Honeywell mainframe computers at Headquarters and Honeywell computers at the Field Support Offices. Equipment is at maximum memory, antiquated and is not upgradeable. There are separate Field Support Office telecommunications networks which

require upgrade and redesign.

NCR EPOS back office processors and cash registers are planned for replacement at the Field Support Offices and stores. Future EPOS systems will be implemented overseas and at all Independent Resale Activities, where cost effective.

Virtually all applications systems have been outgrown or are old; some are incompatible between Burroughs and Honeywell mainframes without undergoing data conversion. NAVRESSO'S modernization approach is to replace the existing applications with fully integrated, "state of the art," off the shelf systems which have been proven in the commercial sector. The future systems must have the capacity and capability to support the NAVRESSO long range strategic vision.

NAVRESSO plans to fulfill this vision by outsourcing for the applications systems and the equipment (or processing service) over a 24 month period. The redesign of the telecommunications network is planned after the transition to the selected vendor's system.

MARINE CORPS (MWRSPTACT) BASELINE POSTURE MODERNIZATION PLAN (Refer to Attachment 3, Appendix C, for details on the baseline.)

Mainframe computers are obsolete and no longer manufactured by NCR. These processors are to be replaced in 1991 and 1992 with open architecture hardware, universal operating system, and with increased capacities and capabilities.

Scanning will be added to the electronic point of sale instore systems within a year. Migration to PC based registers will occur as cash registers require replacement.

Telecommunications consists of leased lines within field commands for data transmission and check verification. Communications to and from Headquarters is accomplished via dial-up. Credit authorization is accomplished through the Sears Payment System.

Application systems are 10-15 years old except for the Investment Management and Construction Financial Management Systems which were developed within the last few years and are currently providing desired results. The accounting and fiscal systems will be replaced by a state of the art, off the shelf package. If required, it will be modified to fit the business requirements of the organization.

Where feasible and desirable, other application systems will be replaced with off the shelf "state of the art" software packages and modified if required. If processing requirements cannot be met off the shelf then they will be developed inhouse using a fourth generation programming language and computer assisted systems engineering (CASE) tools and a relational data base management system.

MIS SUPPORT FOR A TOTAL EXCHANGE SERVICE CONSOLIDATION

The businesses that an organization chooses to engage in and the manner it which it elects to operate those business dictate the requisite MIS support

infrastructure and systems.

To meet future competition, improve customer service, and increase efficiency, AAFES has strategically planned to use technology. AAFES will place computers at store level, build new systems to automate manual functions and distribute information through a satellite communications network. This will tie the stores, distribution centers, suppliers and the corporate headquarters together for tactical short range decisions and execution as well as for long range competitive posture.

The satellite antennas installed for the data communications network will also be used to receive business television transmissions. By connecting a video receiver to existing antennas, each location will be capable of receiving business television broadcasts. The potential uses are limitless; question and answering, technical meetings, management communications, and others, all with active participation from stores.

Based on the obsolete condition of equipment and applications software of the Navy and the Marine Corp, they have chosen to outsource or use "off the shelf" applications systems. In the case of NAVRESSO, they have elected to outsource all of the systems as well as the data processing and telecommunications services. To achieve the "state of the art" level of MIS through outsourcing, the NAVRESSO has accepted the fact that selection of an entire commercial retail system requires an alteration in their methods and procedures of doing business. The Marine Corp will alter their selected packages to fit their current method of operation.

Each service is pursuing a modernization plan based on its unique needs and current baseline. In all cases, justification for the methodology being used is well-based, sensible, cost effective, and makes the most sense for each individual service. If it is determined that the exchange services will remain separate then each service will pursue its own modernization plan.

If a partial consolidation or cross-support of MIS was attempted, it would result in a myriad of interface requirements, technical challenges and organizational and management control considerations. In short, regardless of how well the systems worked, any remote shortfalls in support would be the fault of the supporting agency. This MIS alternative has every indication of being unworkable in the real world and more likely, not the most economical.

However, if the decision is made to consolidate the three exchange services based on central purchasing, elimination of redundant distribution centers and channels, etc. for reasons of economies and good of the customers, only the AAFES MIS infrastructure is capable of supporting the worldwide operations of this consolidated military exchange service.

An MIS Consolidation Study was accomplished to develop the estimated costs associated with the migration of the Navy and Marine exchange services to the AAFES MIS infrastructure once the

services were merged. This study indicates that the migration could be accomplished in a cost effective manner. The MIS consolidation methodology and projected costs are at Attachment 4, Appendix C.

It might be feasible for the Navy to alter their methods of doing business to fit the operational requirements of a new (outsourced) "state of the art" retail system. It would be totally impractical, if not impossible, for all three of the services' worldwide stores and facilities to convert to an entirely new MIS infrastructure. Attempting to change MIS support structures during a merger of the business functions at the same time would be ludicrous.

Consideration of outsourcing for the combined MIS requirements of a consolidated, worldwide exchange service pre-supposes that there are other companies that can satisfy these requirements. Such is not the case. Although there are several retailers that are much larger than a consolidated exchange service, not one of them has application software nor a telecommunications network to support the variety of businesses being conducted by the exchanges throughout the world.

This is not to say that another corporation couldn't provide MIS support, given sufficient time, but the existing AAFES infrastructure could accommodate the processing and communications requirements much sooner and far more practically.

AAFES mainframe computers, operating system, direct access storage devices and magnetic tape storage devices are all sufficiently upgradeable to support a consolidated organization.

Many of the AAFES' existing application systems can accommodate the additional workload resulting from consolidation with little problem. All stores, offices and distribution centers of a combined exchange service can use the AAFES telecommunications network for on line communications and decision making. The AAFES integrated inventory control system data bases can handle added SKUs once converted to the AAFES numbering systems.

All the exchange services will have to install or replace EPOS equipment in the future. The Marines are not presently scanning. AAFES' backroom processor is obsolete. The Navy doesn't have scanning overseas nor at some independent stores. Although new EPOS equipment is a large investment, the replacement/installation of it has no bearing on consolidation since it's a common expense to all services.

Navy and Marine stores can be added to the AAFES telecommunications network regardless of EPOS. Once a store is connected to the AAFES telecommunications network with a terminal, that store has access to all the necessary applications systems, i.e., merchandise replenishment, accounting, and data entry, etc.

The AAFES MIS infrastructure can definitely support the data processing requirements of the three exchange services once merged into a new organizational entity.

RECOMMENDATIONS

That, given a decision to consolidate the exchange services for business and economical reasons, the AAFES MIS infrastructure be used to support this joint military exchange service.

That a detailed plan be developed for the orderly conversion to the infrastructure.

The implementation plan should provide for:

o existing operational commitments

o removal of the exchange data processing from the present joint MWR and exchange service of the Marines

o phase down and closure of miltary bases

o proper timing of migration to the infrastructure in consonance with the rollout of new projects to avoid turbulence and redundant training.

CHAPTER 7

OPERATIONS MANAGEMENT

7.1 OVERVIEW

The Operations Management focus was on defining acceptable service levels and review existing military exchange systems for conformity. Orientation was store level operations and customer interface. The principal concern was to ensure that any proposal for consolidation would not degrade present levels of service.

Since military exchanges, unlike commissaries, offer a myriad of goods and services, the operations management focus was divided into three distinct segments: Retail Operations, Services Operations and Food Service Operations. This chapter will provide a baseline assessment of retail operations. The review ill examine the operational similarities and objectives of each service. Paralleling the retail operations review, a subjective analysis will be made of external factors which are impacting retail profitability and store operations.

Many of the issues discussed in this chapter overlap discussions in other functional chapters of this report. This is only natural since retail store operations is the point in the funnel where distribution and inventory management procedures, which were developed in conjunction with business strategies, are brought together. At store level, cash registers still have to be manned, shelves stocked, floors cleaned, and needs of the customer satisfied, regardless of overhead (headquarters) directions. For these reasons cost savings are difficult to quantify. Since an elimination or reduction of functions may correspond to a perceived reduction in service to customers, recommendations which improve service should receive the

highest priority for implementation in either a consolidated or status quo mode of military exchange operations.

7.2 CUSTOMER SERVICE

BACKGROUND

Management Horizon's "Retailing 2000" report states that "retailing is, by its nature, a dynamic and fast-changing industry. Given that major reductions in patron base are expected within the next decade due to base closures and troop reductions, it becomes imperative that the military exchange services keep their focus on the customer to ensure that they are satisfactorily served. More importantly, the financial viability of each exchange system and associated associated Morale, Welfare and Recreation Programs depend on meeting these customer expectations. The challenge, therefore, is to establish and define acceptable levels of customer service and to maintain them.

DISCUSSION

William Davidow and Bro Uttal, in their article "Why You Need a Service Strategy" advocate that in those industries where the competitors are roughly matched, those that stress customer service will win. The essence of any customer service strategy they surmise, is to segment the customers they serve and focus on satisfying these customers expectations of a successful shopping environment.

Each military exchange system, however, experiences two pervasive challenges. First; it is expected to serve the needs of the junior enlisted man to the highest ranking flag/general officer and their families. Given this responsibility to be all things to all customers, the services have exhibited extraordinary marketing acumen in developing niche strategies. In some stores takes the form of specialized merchandising programs (Big and tall Shops, Brand name shops, Godiva Chocolate Counters) or shopping outlets which serve a specific market (Furniture stores, Sporting Goods Store, Fine Jewelry shops). Secondly, while in Conus and some overseas locations though

shopping alternatives to the local base exchange may exist, for the vast majority of junior enlisted rated personnel the military exchange is their only option. Lack of basic transportation, operational requirements, or initial unfamiliarity with the local environment creates this situation for active duty military members and their families. Likewise, at numerous remote bases with minimal shopping alternatives, the service exchange systems have made a conscious management commitment to operate exchange activities at a loss, if necessary, in order to provide goods and services to these authorized and deserving patrons.

A subjective review of customer service must compare the expectations of the patron to the attitudes or attributes that each exchange system employ to satisfy these expectations. This analysis is divided into four areas:

- Corporate Culture

- Organization Structure

- Employee Involvement

- Customer Service Programs

Based on a former survey conducted by the Navy Resale System in 1988, an informal industry review and conversations with military shoppers, customers expect the following levels of performance one hundred percent of the time:

- Having the item they want in stock.

- Lowest practical price.

- A pleasant shopping environment (clean store, fast checkouts, helpful employees).

Customer service, therefore, becomes the glue that brings what the patron expects to how the retail store should operate and react to shortfalls in customer expectations. Table 7-1 provides a comparison chart of customer service attributes.

CORPORATE CULTURE

In consonance with the Department of Defense Armed Forces Exchange regulations (ASER), each exchange service has established two significant missions:

- Provide authorized merchandise and services to authorized patrons. While the ASER states that these items should be placed at the lowest practical level, only AAFES and Navy address this in their mission statement.

- Provide a source of funds for Morale, Welfare and Recreation.

Our review of each systems commitment to customer service indicates that all services have developed a corporate objective or included in their business strategy a statement that requires development and attainment of

desired levels of customer service and convenience. Navy Resale has developed a sixty-five page "Standards of Patron Service" for its resale activities that must be offered as a requisite of a satisfactory operation. While each exchange system appears to have made a long-term commitment to customer service, no system has indicated this commitment to customer service in their mission statement. Likewise, not all services have developed measurable and definable standards of patron service.

ORGANIZATION STRUCTURE

A. Kolbet Schrichte, Former-Executive Vice President for the American Logistics Association, advocated in a recent magazine article that the key for 1990 is listening to the customer. Arguable, the proximity or strength of the communications channel with each system's merchandise buyers and exchange customers is directly related to satisfying the needs and wants of their customers. In the AAFES structure, the buying function is located at Headquarters in Dallas, Texas. Customer desires must be directed to the buyer by store management. Buyers visit four-five stores annually. Navy Resale has its buyers located at the region headquarters for a Field Support Office supported exchange and at the local facility for an independent exchange. Input on customer wants are received from the Retail Operations Manager/Merchandise Manager. NAVRESSO reports that a large portion of a buyer's time is involved in store visits. The Marine Corps Exchange system has its buyers located at the local installation and are readily available to the customer.

EMPLOYEE INVOLVEMENT

In the simplest sense, the true test of customer service comes when the customer comes in direct contact with an employee. The review of employee involvement focused on four areas:

- Adequacy of customer service training

- Retention of employees

- Employee incentives

- Customer contact employees empowered to solve problems

Each exchange service incorporates into their indoctrination program, or as a condition of employment, completion of a commercially procured customer service program or a commercially developed customer service self-study course. After this initial training, normally within three to six months of hiring, no further mandatory customer service training is required.

Turnover for retail sales associates is reported to be 80-150% annually for the three military exchanges. Given that one of the primary reasons for turnover is relocation of the active duty military spouse, no mechanism exists to place or

encourage these trained employees to seek employment at an exchange (any service) near their new residence.

Recognition or monetary incentives for employees who excel in providing customer service parallels those examined in civilian retail organizations. These rewards take the form of instant cash awards, quality step increases, letters of appreciation, or selection as employee of the month/quarter/year. In developing a customer service partnership with their employees, retail industry leaders such as Nordstrom and J.C. Penney utilize sales incentive programs. Though each exchange system has tested sales incentives, they have not been universally or consistently applied.

Unfortunately, the lowest paid store employees are the customer contact personnel. Coupled with the high turnover rate, providing a positive uniform level of service becomes a challenge for store management. Each service closely examines store manning, and ensures that adequate supervision is given to employees in providing service and responding to the needs of the customer. AAFES' Sales Plus program, which objectively associates desired levels of customer service with particular merchandise departments, is being introduced in large main stores to enhance patron satisfaction. Navy and Marine Corps through different methodologies have accomplished the same objective.

CUSTOMER SERVICE (PROGRAMS)

Through the use of local customer advisory boards, customer service hotlines and mystery shopper programs, each service exchange system receives performance feedback. Additionally, AAFES requires their stores to conduct local surveys to evaluate service and NAVRESSO conducted a system wide, independent review of customer satisfaction in 1988.

SUMMARY

Each system within their organization structure and management commitment, has attained a desired and unique level of service and is working aggressively to refine customer service strategy and objectives. It should be anticipated that any degree of consolidation will create some level of confusion to the customer. To those service loyal shoppers, changes may be viewed as a degradation of customer service, though the impact should be minimal. Looming above the customer service umbrella, is the financial responsibility that the resale systems have to their Morale, Welfare, and Recreation Programs. Recent cutbacks in appropriated fund support to MWR has caused them to guarantee or project, in some cases unrealistically, financial earnings. It appears therefore that because of differing "bottom line" pressures, a "customer first" philosophy is taking a back seat to

profitability. This emphasis on profit making and failure to provide positive and clear guidance with regard to customer service will result in a loss of patron loyalty and eventually sales.

RECOMMENDATIONS

1. Include providing acceptable levels of customer service as a part of the military exchange mission statement.

2. Each exchange service should develop measurable and desired standards of patron service.

3. Each system develop mandatory customer service refresher training programs.

4. Review possibility of intra/interservice resale rehire program.

5. Examine the feasibility of a retail commission sales incentive program.

6. A business review of Morale, Welfare, and Recreation programs should be made to examine the viability of consolidating with military resale activities.

TABLE 7-1
CUSTOMER SERVICE ATTRIBUTES

	AAFES	Navy	Marine Corps	Industry
Mgmt Commitment	X	X		X
Standards		X		
Buyer Location	Ctr Hdqtrs	Regional	Local	Mixed
Customer Service Training (1)	X	X	X	
Incentives	X	X	X	
Local Advisory (2)	X	X	X	
Mystery Shopper (3)	X	X	X	
Customer Service Review (4)	X	X		
Customer Service Hotline (5)	X	X	X	

1 - All programs are initial training. No refresher courses available.

2 - Navy Notes must be sent to NAVRESSO

3 - Being introduced by AAFES

4 - Independent review by NAVRESSO

5 - Local level only for Marines

7.3

APPROPRIATED FUND SUPPORT (APF)

BACKGROUND

From an operations perspective, the review of Service Directives involving Appropriated Fund Support of Military Exchanges indicate that within CONUS all exchange systems are generally provided support for common use areas, grounds maintenance, maintenance and repairs to Class II property, and Fire and Police protection. Overseas base commanders are additionally tasked with providing utilities on a nonreimbursable basis to the location exchange. First destination transportation charges of resale items to OUTCONUS exchanges are also supported by appropriated funds.

DISCUSSION

The level of directed nonreimbursable appropriated fund support provided by each service has a direct effect on the operations and profitability of military exchanges. Though the service directives explicitly delineate the areas of APF support, base commanders establish the priority, amount, and timing of that support. At the installation commanders Focus Group meeting on 18 July 1990, convened to provide the commission perspectives on local command relations with the military exchange, it was generally acknowledged by this representative sampling of commanding officers, that because of cuts in their base APF support, they were restricted in providing full support to their exchange. Examples of this dilemma exist at Fort Meade, Barksdale Air Force Base, Fort Chaffee, and Little Creek Naval Amphibious Base, where gasoline service pumps have been secured due to leaking underground storage tanks. Repairs to these facilities have been deferred contingent upon the availability of local APF. The forced shutdown of these facilities negatively impacts on the customer support image provided by that exchange, and the amount of funds that can be provided to that service's Morale, Welfare and Recreation programs.

RECOMMENDATION

7. APF support directed by service regulations must be provided in a timely manner to the service exchanges.

7.4

EXCHANGE-COMMISSARY RELATIONSHIPS

BACKGROUND

Commissaries and exchanges each have particular missions in meeting the needs of the service member. While their missions are similar in that they both provide authorized goods to authorized customers, they differ in pricing and profit strategies. Commissary items are basically priced at item cost and sold to the customer with a 5% surcharge. This surcharge provides funds for construction, store operating expenses and minor repairs and renovations. All payroll, utilities, and common support services are paid for with Appropriated Funds (APF). Exchanges attempt to sell products at prices which result in an average customer savings of 20%, yet generate supplemental monies for Morale, Welfare, and Recreation programs. Exchanges are essentially self-sufficient, with the cost of operations included in the price of merchandise sold. Minimal APF is available. With commissaries normally located on bases which have an exchange, natural competition exists between the two programs.

Ninety percent of items authorized by DoD 1330 17-R as commissary items are also authorized by DoD to be sold in exchange outlets. The issue for the customer becomes one of either price or convenience.

DISCUSSION

Now that approval has been given to operate commissaries under a consolidated concept, the ability for the services to determine which authorized items may be stocked in their respective service commissary is diminished. Preliminary analysis of placing cigarettes and sodas in Navy and Marine Corps commissaries indicates a "most likely" scenario of a $8.9 million loss in profits. This will seriously impact on NAVRESSO ability to provide funding support to MWR.

RECOMMENDATION

8. The commissaries coordinate with the exchange systems prior to the addition of non-essential general merchandise to their stock assortment.

7.5
EXCHANGE AND MORALE, WELFARE AND RECREATION RELATIONSHIPS

BACKGROUND

Army Regulation 60-10, Air Force Regulation 147-7 and Chief of Naval Operations Instruction 1700.7D, direct that their appropriate exchange service will be the primary source of resale (nonsubsistence) merchandise and services on their military installations. Army, Air Force, and Navy MWR activities may engage in resale and service activities when authorized by installation commander, with concurrence from the servicing exchange manager, or where the types of merchandise and services being sold are directly related to the purpose and function of a specific MWR activity and it is determined that a resale requirement of a particular MWR activity cannot be met in a responsive manner by a military exchange.

In 1989 the Marine Corps completed a consolidation of Morale, Welfare and Recreation activities with their exchange service. Under the leadership of the Director, Marine Corps, Morale, Welfare and Recreation Support Activity, Manpower Department, Headquarters, U. S. Marine Corps, this organization is tasked with providing goods and services and ensuring wholesome athletic, recreation leisure time activities are available.

DISCUSSION

Unwarranted proliferation of competitive resale outlets is counter-productive to the overall effectiveness of the military exchange system, and creates unnecessary duplication of personnel, functions, inventory and facilities. It was noted during tours of Navy and AAFES facilities on Naval Base, Norfolk, VA, and Ramstein AB, Germany, that significant competition exists between exchange and MWR activities. Amusement games located in the newly opened MWR Norfolk Sports Bar are averaging $25,000 a month in sales. The Ramstein MWR Photo/Video and Sports Club, located in a 25,000 square foot facility, generated almost $5,000,000 in sales for FY 89 by selling name brand merchandise which is sold simultaneously at the Ramstein exchange.

Although the study group is concerned over the turmoil expected from separating the Marine Corps MWRSPTACT into two distinct programs, the exchange operations separation would be necessary in order to realize the total benefits derived from consolidation.

RECOMMENDATION

9. Each service should strictly enforce guidelines on resale responsibilities.

7.6 PRICING

BACKGROUND

Pricing strategy is one of the most important and critical aspects of a retail business. Military exchanges are somewhat unique because several different strategies must be used in order to keep the exchanges competitive, yet still realize sufficient net profit. Due to the diversity of merchandise stocked in exchanges, pricing must be set to compete with traditional department stores, specialty stores and major discounters. Exchanges must continually shop the competition and utilize variable mark-up schedules to offer the best overall savings to the patron and still maximize net profit.

DISCUSSION

The goal of all exchange services at the present time, to offer an overall 20% average savings to the patron, is being accomplished. However, the approach to reaching this goal varies somewhat for each exchange. All systems have identified price leader merchandise which is items that are priced very competitively. Longer mark-ups are then used on some merchandise to offset these low mark-ups and still maintain the overall gross margin.

AAFES uses centralized pricing, keeping the majority of prices the same in all stores world-wide. NAVRESSO sets prices by region. The Marine Corps uses decentralized pricing focusing on the local retailers to ensure exchanges are competitive on a local basis.

Each exchange system's pricing policy allows competitive pricing as was discussed in Chapter 4.

RECOMMENDATION

10. That the exchanges jointly contract for an independent price survey to be conducted by prescribed regions.

11. That consideration continue to be given by all services to pricing merchandise competitively with local retailers.

12. That services share pricing information (both cost and sell) to encourage commonality in pricing by geographical area.

7.7 RETAIL STORE ORGANIZATION

BACKGROUND

Review of each exchange service's retail store structure indicates wide variation in management staffing and grading.

AAFES

As previously mentioned in the customer service subsection, AAFES centralized buying philosophy requires a strong communication channel to join the headquarters buying staffs with customer preferences to facilitate "pulling" merchandise through their distribution channel. Responsibility is given to the main store manager through his administration of the open-to-buy inventory management program. This program requires him to daily monitor sales performance to ensure that his store is satisfying customer needs. To assist the store manager in identifying these needs and also to provide a dynamic approach to customer service, AAFES devised the "sales plus" program. Table 7.2 provides a diagram of the"sales plus" organization at a large main store. This organization is intended to provide the store manager with knowledgeable management level talent to accomplish his mission.

NAVY

Since buyers with the Navy Resale System are located regionally (FSO supported), or locally (independent), the primary role of their retail store organization is to provide a pleasant shopping environment for the shopper. Store managers do not have significant open-to-buy buying responsibilities, but are tasked with communicating frequently with closely located buyers about customer preferences. Table 7.3 provides a pictorial of the retail store organization at a typical large resale activity.

MARINE CORPS

Within the Marine Corps decentralized environment, buyers and retail store personnel are co-located. This type of organization provides optimum responsiveness to customer preferences and allows flexibility to each store manager in developing his stock assortment. Minimum management level talent is needed on the sales floor since customers can easily communicate with buyers.

DISCUSSION

Outside the direct retail store organization, the Marine Corps and

Navy local exchanges are headed by an officer or senior enlisted personnel. These individuals either possess some combination of formal training, or experience that allows them to manage these facilities. Salaries for the military individuals are funded by appropriated sources and are not a charge to the operations of these two service exchange systems. The value of military personnel is indeterminable, but supports the long standing policy of the Navy and Marine Corps to have military at every level of command in their organization.

An analysis of creating a consolidated retail store organization is provided in Table 7.4. This structure assumes a centralized procurement organization and employs a customer satisfaction philosophy at store level. Using the AAFES store hierarchy to restructure the Navy/Marine Corps exchanges, it is anticipated that $13.3M in additional payroll costs will be incurred. This should be offset by savings identified in Chapter 4. We did not assume that either a sales gain or loss would be realized from this change in organization structure.

RECOMMENDATION

13. The Navy and Marine Corps review the role of military personnel in their respective service exchanges.

SALES-PLUS MAIN STORE ORGANIZATION: $23 MILLION/YEAR & ABOVE

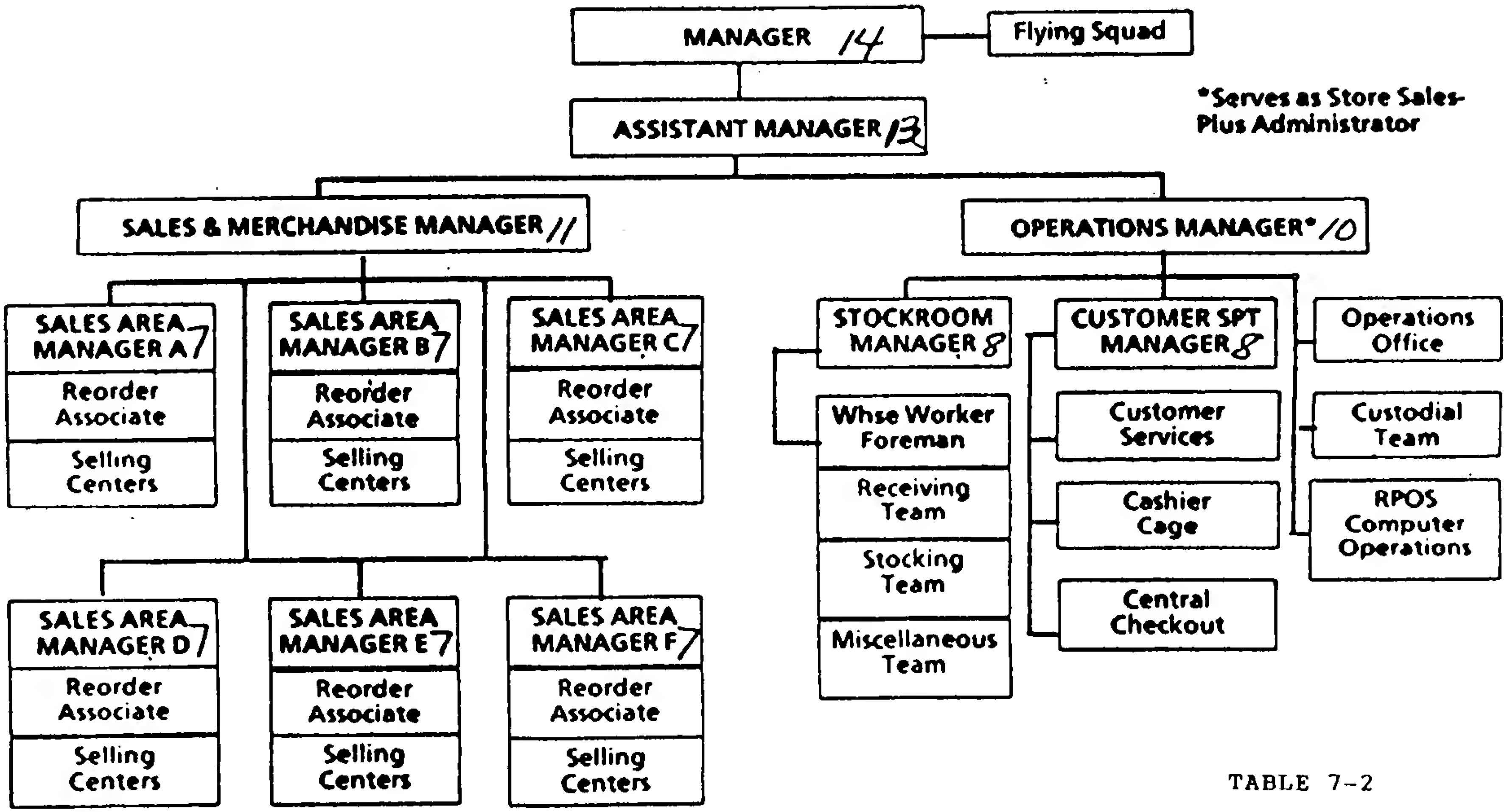
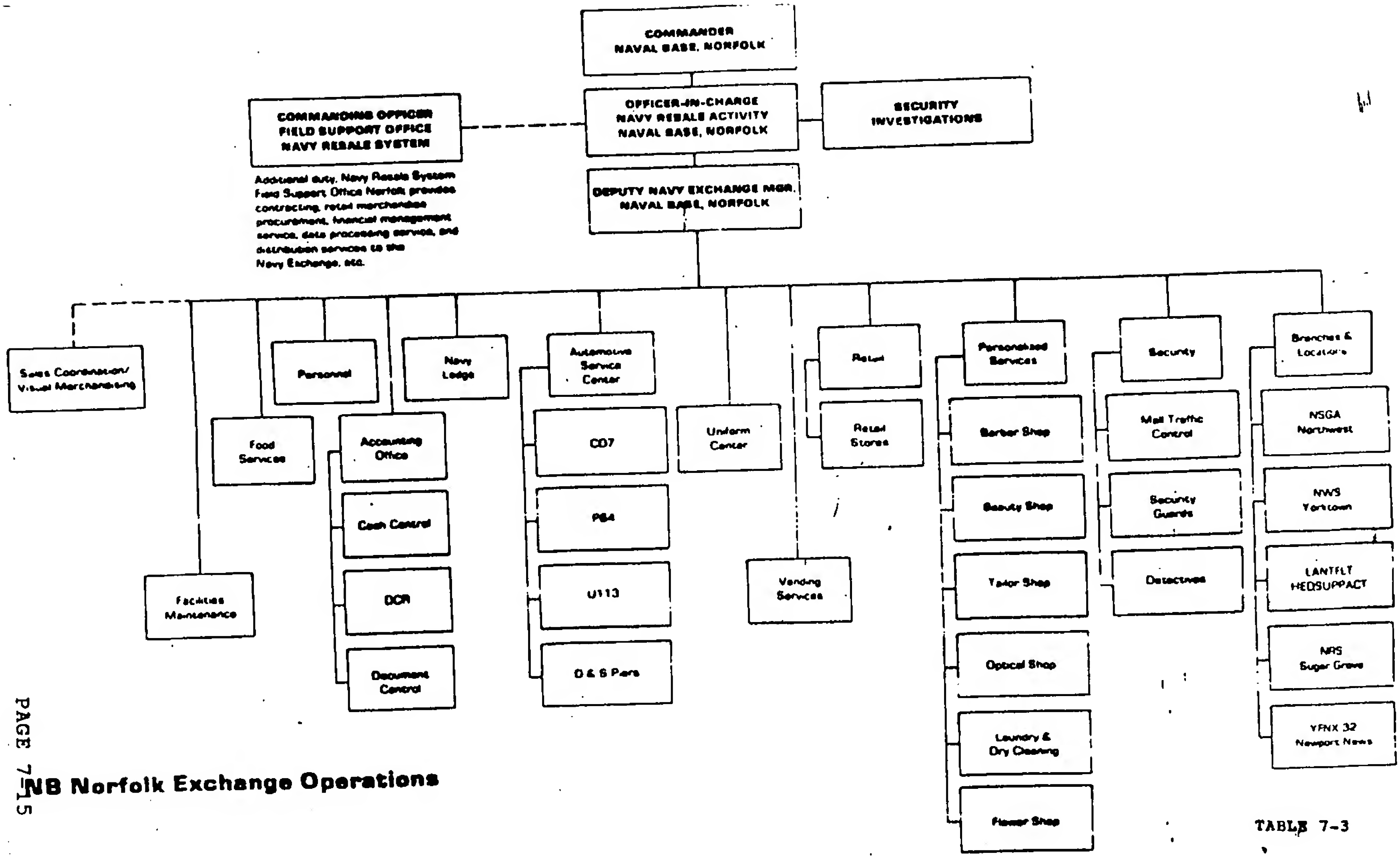


TABLE 7-2



NB Norfolk Exchange Operations

TABLE 7-3

TABLE 7-4
RETAIL SELLING PAYROLL
ANALYSIS

	Navy	Marine Corps	AAFES
1989 Sales	1.34B	.39B	5.33B
1989 Payroll (%)	8.4	10.4	10.0
Adjustments: Procurement	(1.0)	(1.5)	
Warehouse		(.7)	
Acctg/D.P. Clean/Security	1.9	.8	
Comparison Basis	9.3	9.0	10.0

Added costs:

Navy (10.0 - 9.3) x 1.34B = 9.4M

M/C (10.0 - 9.0) x .39B = 3.9M

13.3M

7.8 PAYROLL CONTROLS

BACKGROUND

Payroll is the largest manageable expense in an exchange and as such must be tightly monitored and controlled. Top management is responsible to determine desired customer service levels as well as delicately balance service requirements with available financial resources. Customer service level requirements throughout the exchange vary. An exchange is a myriad of small businesses and requires various levels of customer service in order to be successful in each. Self-service commodities such as health and beauty aids, food and beverage require little or no personal contact but rely on proper signing and display. Other areas require a limited degree of service such as soft lines, hardware, automotive accessories, home and garden. Merchandise categories such as shoes, cosmetics, and jewelry require an intensive level of personal service and product knowledge. Professional and/or technical service is a necessity in consumer electronics, cameras and computers.

Customer Accommodation Centers require expertise in special orders, layaway and refund procedures and always require one-on-one service.

Exchanges typically have a main store and various outlets to include convenience stores, toyland and garden shops, beverage stores and sporting goods stores, each with hours of operation which differ according to area.

Proper scheduling of receiving and stocking crews is paramount to the success of a store in order to properly and swiftly keep merchandise flowing to the "point of sale."

From the customers' perspective, service includes having the right merchandise in stock at the right time and at the right price, friendly and informed salespersons, a pleasant shopping environment and, once they have made their selection, the ease and speed of checkout as well as confidence that the exchange will honor its "Satisfaction Guaranteed" Policy.

From the financial management perspective, payroll control is living within budgeted payroll dollars.

DISCUSSION

Each of the exchange services differ in the way stores are sized, designed and replenished. Each exchange service also differs in terms of what functions are charged to direct selling payroll as opposed to general expense, making a true comparison of direct selling cost difficult at best.

AAFES charges all persons assigned to a given store (or selling location) to direct

selling payroll. This would include visual (specifically assigned) custodial, cashier's cage and point of sale computer operations. The Navy exchange charges visual, custodial and computer operations to general expense as does the Marine Corps.

Navy charges the procurement function as a cost of retail operations, while AAFES places this charge against general expense.

AAFES has established payroll standards for each department and job type as defined in AAFES Sales Plus Program. Sales Plus also delineates a specific management structure for each store based on sales volume. AAFES, as an integral part of Sales Plus, utilized NCR's Labor Management System (LMS), a mechanized method of producing payroll schedules. The LMS system forecasts weekly sales, by store, by department, applies a standard, and produces daily and weekly payroll schedule. The standards utilized were developed by a retail consultant for AAFES. Navy and Marine Corps Exchanges utilize a cost control staffing method based on productivity goals set by each exchange, applied against a specific payroll budget. The Navy exchange has initiated implementation of LMS in several West Coast and Southeast exchanges.

Each exchange service conducts traffic counts to determine peak selling times during each day. Adjustments are made for paydays, holidays, troop/fleet movement. Consideration is given to specialty sales areas such as shoes, jewelry, cosmetics, cameras, home entertainment and computers. Part time and intermittent sales help is utilized for flexibility in scheduling to provide better sales and to stay in line with budget constraints. Payroll is adjusted for increases and decreases in sales to budget. Vendor service is utilized by all services where available and cost effective.

RECOMMENDATION

14. The exchange services establish a uniform method of charging direct selling payroll for comparison purposes.

15. Navy and Marine Corps Exchanges develop direct selling standards that conform to their unique type of operations.

16. Navy exchange expand utilization of LMS. Marine Corps consider implementing a Mechanized Labor Management System. Mechanized Labor Management Systems will optimize salesfloor coverage and maximize visibility of payroll expenditure compared to budget.

17. The exchange services share vendor service information in order to maximize utilization of same.

7.9

AAFES IMPREST FUND ACTIVITIES (AIFA)

BACKGROUND

At locations where it is impractical to provide service through regular exchange outlets, service may be provided by an AIFA. An AIFA functions by joint agreement of the site commander and AAFES

DISCUSSION

An AIFA is established and operated to provide SERVICE to military personnel where no exchange exists, where the military strength of the installation is relatively small, where the distance from an established parent exchange would make direct operation of an exchange by AAFES impractical, and where the average monthly sales won't exceed $10,000.

AAFES imprest funds are issued to support only retail activities. AIFAs receiving these funds may use them only to purchase merchandise from designated AAFES exchanges. Operating supplies and equipment are furnished by AAFES.

An AIFA is activated only when detailed working arrangements have been developed between representatives of the installation commander and the general manager of the AAFES geographical area where it is located.

The AAFES general manager determines the amount of the permanent imprest fund to be issued, up to a maximum of $10,000. This amount is determined by the projected total dollar value of the first merchandise issue, plus allowances for seasonal and special merchandise as well as a change fund. Region chiefs/overseas commanders may authorize a temporary increase, not to exceed six months, in the amount of the fund to $30,000 to support a large deployment of troops to an AIFA location for training exercises.

An AIFA generating monthly sales of over $10,000 will be converted to a direct reporting operation. However, an AIFA generating monthly sales of over $10,000 (maximum $30,000) may continue to operate on an imprest fund basis, if the site is remotely located from the parent facility and the corresponding Installation, Morale, Welfare and Recreation Fund (IMWRF) makes the local dividend payment to the unit fund operating the AIFA.

The location and number of facilities and annual sales for FY 87 are provided below:

LOCATION	NUMBER	ANNUAL SALES
EUROPE	133	$ 6,008,400
PACIFIC	11	414,000
CONUS	23	936,000
TOTAL	167	$ 7,358,400

RECOMMENDATION

18. Imprest Fund Stores be allowed to operate under their present guidelines.

7.10
SALES/MERCHANDISING PROGRAMS

BACKGROUND

Sales promotions are being regularly offered by each of the three exchange systems to increase sales and earnings. AAFES schedules 52 system wide promotions every year which are mandatory for 151 stores. These are typically supplemented by local promotions at the discretion of the exchange manager. The Navy Exchange scheduled 30 events for FY 90 with 15 being system wide, mandatory for 43 stores, and 15 developed by NAVRESSO for mandatory use by the Field Support Offices (FSOs). In FY 91 they have scheduled 36 events with 18 being system wide. The FSOs are encouraged to offer additional promotional activity to supplement the HQ directed program. Because the Marine Corps Exchange is a decentralized operation, they rely heavily on locally developed weekly promotions at their 18 installations. They scheduled three system wide promotions for FY 90 and four for FY 91. All of the exchanges take advantage of cooperative advertising from vendors, but the Marine Corps Exchange sometimes has difficulty spending their allocations because of not being able to shift unused funds from one installation to another that could use the support.

Merchandising programs are many and varied in all of the exchange systems, and as with sales promotions, there are both similarities and differences among the three systems.

AAFES

AAFES has several merchandise programs that offer value to their customers. Below are just a few of their most visible programs:

The AAFES Brand Program (house brand) includes items in basic categories targeted for the customer wanting good quality and value at the lowest price. While most of these use AAFES as the brand name, some will have an exclusive AAFES family brand, such as the "Go Power" automobile battery. Annual sales in FY 89 were $74.5 million.

The Private Label Program features items with "brand names" that are owned by AAFES, but are not readily identifiable as AAFES merchandise, e.g., Cavallon shirts and Athletic Club shoes. There are four worldwide and six overseas-only AAFES private labels. Annual sales in FY 89 were $20 million.

The Extra Value Program includes high volume, branded merchandise priced at an extremely competitive label. This program encompasses items specially priced (below cost if necessary) to meet "footballing" by commercial retailers, such as national brand health and beauty aids. It also includes specially priced clothing, and gives visibility to all that reflect the Extra Value criteria.

The Special Buy Program includes one-time-buys in all categories of merchandise having considerable customer appeal because of exceptional pricing, limited availability, special offer packaging, etc.

The Best Price Program, which is currently being tested at Fort Hood, Fort Riley, and Keesler AFB, commenced on 1 January 1990. This program adopted the policy of matching any competitor's regular/promotional price on any item everyday. It emphasized AAFES' everyday low prices their image as a price leader and the preferred place to shop.

The Jewelry Caravan Program in FY 89 involved 145 events generating $7.6 million in sales. This program features a fine jewelry assortment with a portable kiosk moved from store to store. There are 192 scheduled events for FY 90, including more of the smaller stores this year.

Plan-O-Grams. AAFES began the first phase of its mechanized space management system in September 1989 and it will continue through the middle of 1991. Starting in 1991, customized plan-o-grams will be produced. The objectives of this program are to increase sales, improve turns, increase return on investment, maximize in-stock position, improve space productivity and enhance merchandise presentation.

NAVY EXCHANGE

The Navy Exchange also offers a variety of merchandising programs for its customers. Below are a few of their programs:

The House Brand Program has the same features as the AAFES Brands Program. They use a Compare and Save Program to target national brands, similar to the AAFES brands being displayed next to its look alike.

The Navy's Private Label Program is continuing to expand in softlines. They are targeting popular brands, such as Osh Kosh, with Kids Ahoy for toddlers and children. They offer Harbor View for men and women and will soon rollout Typhoon for boys and The In Club for girls. This program provides excellent value and quality for their customers.

The Super Value Program provides opening price point items, which offer exceptional value and good quality in softlines.

The Green Tag Program offers a 15% savings for short term promotions.

The Image Pricing Program was initiated in April 1990 to identify the lowest prices in the area and then meet or beat the competition. In CONUS the Navy Exchange surveys commercial retailers and overseas AAFES' facilities are surveyed.

Plan-O-Grams. The Navy Exchange places a great deal of emphasis on their plan-o-grams. It is the cornerstone of their merchandising policy and is utilized extensively for category and department adjacencies.

MARINE CORPS EXCHANGE

The Marine Corps Exchange also offers system wide merchandising programs for its customers. Below is a summary of their best programs:

A House Brand Program is not offered, but they do provide their customers with a Generic Label available through their distributor.

In April 1990 they implemented a corporate ABC Program, or Assured Buyers Confidence Program. This program will serve as the umbrella for the Price Leader Program and the Patrons Bill of Rights.

The Price Leader Program is centrally directed with 220 to 240 items identified for local surveys, and prices will be set to meet or beat the competition.

The Patron Bill of Rights is a program informing their customer what to expect in terms of customer service when they shop their exchange. They have the right: to be informed, to be heard, to safety, to redress, of choice, and to service.

DISCUSSION

There are improvements, benefits, and efficiencies that could be gained through a single promotional program for the three systems. However, because of the myriad of differences in marketing strategy, such as pricing, purchasing, stock assortments, advertising, and merchandise distribution, the systems could not establish a cost/benefit relationship that would support consolidation of the sales promotion programs.

All of the systems offer their customers a variety of merchandising programs emphasizing value and quality. Two programs, specifically House brands and Private Labels, were identified as successful programs that lend themselves to centralized development, purchasing, and control.

RECOMMENDATION

19. The systems should develop a consolidated program for House Brands and Private Labels.

7.11 SALES TRAINING

BACKGROUND

Sales training has been emphasized extensively by the exchange systems. All of the systems have concentrated on improving product knowledge to improve service and sales, and they are all consistent in their use of vendor training (in-store or product seminars), videos, and On-the-Job-Training. Below is a sampling of programs from each system:

AAFES

The Sales Associate Certification Program was rolled out in January 1990. With the successful completion of all 12 modules, sales associates are awarded a personalized name tag identifying them as service professionals, a certificate of achievement, and their own personalized business cards. This program requires approximately 20 hours of training.

There is a Sales Motivation Course with 5 modules covering "The Real Meaning of Service," " Selling Yourself,"You Are AAFES," "The Customer's Buying Cycle," and "Building a Winning Sales Attitude."

There are job training plans for the 23 different Hourly Pay Plan (HPP) retail positions.

The Executive Development Program is designed to provide a phased, systematic approach to executive level training. The program gives selected UA managers, either upward mobility employees or college graduate trainees, an introduction to market information, executive skills and integrated management functions with subsequent advanced level reinforcement. AAFES operates a Management Training Center at Fort Hood, which is where the selected UAs are given their basic training (4 weeks), and then they are transferred to a training location for OJT (19-34 weeks).

The Professional Development Program establishes prerequisite training requirements for each UA job title and grade. It prescribes training that must be completed before being considered for assignment or promotion to a new or more complex position. There are three Professional Development Courses, designed for Main Store Managers (University of Arkansas), Exchange Managers (Texas A&M) and General Managers (Texas A&M for 1989/Selecting new school for 1990/1991).

HQ AAFES conducts a Leadership Training Course, "Management Development," several times a year for selected retail managers. This training package was put together for AAFES by the Evans Group, which specializes in leadership training.

NAVY EXCHANGE

The "Feelings Customer Service Program" introduced in 1986 and has been very successful in improving the level of service in the stores.

Publication 200 is an extensive training guide with job training plans and videos for all retail positions.

The "Standards of Patrons Service" is published as a pamphlet and a checklist. This guide establishes standards for every area or department in or around the facility.

The Navy Resale Career Academy is a formal in-house training program operating out of Jacksonville, Florida. OICs and UAs, grades 6-12, receive their training at the Navy Supply Course School in Athens, Georgia. This course is rated a pass/fail and classes are ranked for entry into the Official Personnel Folder. The Academy gives formal training in Jacksonville or on the road. Examples of courses are replenishment controls, financial management, cost controls, staffing and customer service training.

NAVRESSO's Manager-In-Training and Management Intern programs provide a systematic method of introducing newly hired, experienced Resale professionals, College Graduate Trainees and upwardly mobile system employees to the knowledge and skills necessary to become effective professionals. These programs combine formal classroom training with on-the-job training.

The Executive Development Program provides monetary resources to highly motivated UA managers wishing to improve their professional acumen.

MARINE CORPS EXCHANGE

The Marine Corps introduced the "Feelings Program" in 1986 and uses this customer service training in their Indoctrination Program.

Marine Corps Exchange officers may attend the Resale Training Course offered by the Navy in Athens, Georgia.

Navy Resale supplied Self-Study Courses are available to exchange employees.

DISCUSSION

All services have basic programs in place to train sales associates. Shortfalls exist within the Marine Corps system, since no formal training is available for civilian managers or Job Training Plans for exchange employees. Additional discussion on available training can be found in Chapter 11.

RECOMMENDATIONS

20. The Marine Corps Exchange should pursue the development of job training plans.

21. All the systems should review the feasibility of having a common formalized Retail Management Training Program for military and civilians.

22. All systems should meet periodically to share training initiatives and programs.

7.12

COMMUNICATIONS WITH CUSTOMERS

BACKGROUND

Exchange systems, as instrumentalities of the United States are restricted to only one unsolicited mailing of promotional information to customers or potential customers. Subsequent mailings require the expressed permission of the customer. Consequently, the three exchange systems have made a one-time canvas of their customers asking for permission to send promotional flyers directly to their homes, and built a mailing list from those who returned a positive response.

Under this system, AAFES sends out 16 mailings per year, system-wide, to about 500,000 customers to promote its largest sales events. NAVRESSO mails out 15 system-wide flyers annually to about the same number of customers. MCE currently sends out three special event catalogs annually to about 100,000 customers. Next year, MCE will expand to four special events. All three exchange systems supplement their system-wide mailings with local exchange mailings promoting local events to customers who have asked to receive them.

Other ways in which exchange systems keep themselves in the minds of their customers include press releases of newsworthy events to local media, and by audio/video image spots shown on the local installation-access cable channel within CONUS, or the Armed Forces Network (AFN) radio and television channels overseas. All systems produce "Plain Talk" bulletins, available at exchange locations, to explain the exchange story on a number of different issues.

Additionally, local exchanges of all three exchange systems conduct installation-level programs to generate recognition of and interest in exchange events. These programs include fashion shows, welcome kits to new arrivals at the installation (to include a gift of house brand products), and recognition, through coupons or other considerations, of newborn babies and high achieving students.

DISCUSSION

The restriction on direct mailing to customers without their expressed permission puts exchanges, particularly in CONUS, at a distinct disadvantage with their off-base competitors. Private retailers inundate their potential customers, who include products, services and prices through all available media. The exchanges promotional flyers do convey this information, but since their availability is restricted to those patrons who already shop their exchange, or who have already consented to receive these flyers, their impact is reduced. As the authorized mailing list becomes dated, it will be difficult to keep it up-to-date since any one-time unsolicited mailing aimed at new customers will have to be purged of those previously listed names who did not elect to receive additional mailings.

The "Plain Talk" papers and local promotional events are likewise restricted in influence to those already in the exchange or else to a small, targeted customer segment.

While the image spots aired on local cable or AFN television and radio could reach potential customers (that is, those not already shopping in the exchange), restrictions on the nature of availability and price information that impact on many buying decisions.

An elimination of the restrictions on direct mailing, to allow exchange systems to directly mail promotional materials to customers without requiring the customers' expressed consent, would greatly increase the visibility of the exchange benefit, thereby providing an avenue for increasing exchange customer traffic with its attendant impact on sales and earnings.

RECOMMENDATION

23. That the restriction on exchanges directly mailing unsolicited promotional materials to customers be eliminated.

7.13

TRADE INDUSTRY RELATIONS

BACKGROUND

On 25 May 1990, the Military Exchange Study Group met separately with leaders from the American Logistics Association (ALA) and the Armed Forces Marketing Council (AFMC). The following are excerpts from published minutes with ALA:

Lloyd Johnson, ALA Chairman, provided what the ALA group believes to be the consensus of industry's opinion relative to consolidating the exchange systems. The input was augmented by comments and examples from the other ALA representatives.

a. Consolidation could bring potential savings to the military.

o Closing of regional buying offices at FSO's and Marine Exchanges. (But some regional buying will always be required to handle products such as soft drinks).

o Closing of regional warehouses.

o Reduction of backroom stock in Navy, Marine Corps, and Coast Guard.

o Reduction of inventory (both the level of inventory and the duplication).

o Elimination of regional payment systems.

b. Consolidation could bring potential savings to the supplier.

o Freight costs.

o Fewer selling points, but in-store merchandising and monitoring would continue, which could change the composition of the supplier work force and probably reduce the total payroll expense.

o Clearly many manufacturers would rather keep the higher costs and preserve the selling options so that all their "military sales eggs" are not in one basket.

c. Potential effects on the patron if consolidation occurs.

o It would reduce the shopping options. It is estimated that well over 50% of the CONUS exchange patrons have an option as to which military exchange they shop. If the exchange systems were consolidated, patrons would be subject to a single merchandise offering - the alternative would

now be to shop off base at a higher price.

o It is generally felt that the competition between the services benefits the patron in that it tends to keep prices down, selections adequate, and stimulates creative thinking. Without this competition, it would be easy to let the price differential between exchange prices and commercial retailers narrow. There is more urgency on the part of the military retailer to improve his/her performance when that retailer discovers his system is saving the customer 19.5% and a sister service is saving 20% than the case where the military retailer's savings has slipped from 20% to 19.5% and there is no competition doing better. One-of-a-kind operations are always suspect because no comparisons can be drawn.

o It could reduce patron loyalty. Most service people currently feel the exchange is "their" store be it Army, Navy, Air Force, Marine, or Coast Guard. A consolidated exchange system may produce an image of "somebody else's store" versus "my" store. If consolidation should occur, the separate service names should be maintained.

d. Probable effects on the long term viability of the exchange system should consolidation occur.

o One single DoD exchange system would be easier to privatize than three or four separate service exchange systems. If we assume the exchange system was privatized, the taking over retailer would come replete with stockholders. Any efficiency the commercial retailer may achieve would be more than offset by a distribution of profit to its shareholders. This in turn would reduce the total funds available to support recreation, or would increase the exchange prices to the military patron. Industry is basically opposed to any action which could encourage privatization of the exchange system.

o Most one-of-a-kind organizations become bureaucratic and lethargic over time. Competition with other like organizations keeps a retailer responsive to its customers. Without that competition, extra overhead sneaks in; creative thinking and risk taking wane. Although there is some strong commercial competition, it is felt that the exchange systems, each of which saves the patron roughly 20% on a market basket, competing with each other provides a greater incentive for innovation and results in an ever improving military exchange system.

o Under the current system of separate exchange systems with multiple buying locations, an entire industry subgroup has evolved with military sales departments and organizations which specialize in the military business. In a consolidated system with a single buying location, the feeling is that most manufacturers would dissolve their military sales arrangements and treat the consolidated exchange

system as a national commercial account. The special treatment for the exchanges, and possibly the Robinson-Patman exemption, would be lost.

o A consolidated exchange system would become a power retailer. Big retailers tend to centralize which facilitates dealing with big manufacturers. It is probable that many small distributors and brokers will drop out of the military market which in the long term will reduce sources for the military.

o It appears that one of the logical reasons to consider consolidation of the exchange systems is to eliminate duplications and inefficiencies of having four exchange systems. The elimination of these duplications surely has the potential of reducing costs, thereby making more funds available to support the services recreation programs at a time when appropriated funds are being reduced. The goal of industry is to increase sales to the military. One of the goals of the services is also to increase sales. Sales increases are used as a barometer by the services to show they are providing the goods and services that their patrons want. The fear of many in industry is that with one consolidated exchange system there will be a reduction in the merchandise selection offered the patron. Areas which presently have exchanges from different services that are in close proximity such as Hickam and Pearl Harbor in Hawaii or 32nd Street Navy, Miramar, and Marine Corps Recruit Depot in San Diego, or the several exchanges in Northern Virginia will all suffer a drop in total sales if there was only one merchandise philosophy presented. Many in industry therefore, feel that while there are economies in consolidation, the drop in sales will more than offset those economies, and the result will be less total dollars going to support recreation.

e. Strengths and weaknesses of present systems. Industry generally views the present systems to have these strengths and weaknesses:

Navy Strengths

o New stores are very good.

o Realignment of FSO's initiated by Navy makes sense.

o Corporate flyers are well designed, effectively executed, timely and offer good prices.

o Plan-o-gram program improving.
o Ability of regions to react quickly to special buys.
o Along with the Marine Corps they are generally strong in soft goods.

Weaknesses

o Bill paying.

o Too many buyers vacancies and marginally trained buyers. An individual buyer's span of merchandise is too great.

o FSO's don't always support headquarters initiatives.

o Inventory control and computer MIS support is poor -the Navy is a slave to open-to-buy.

o Headquarters location is bad. New York City pay scale is extremely high. Good field people try to avoid headquarters assignments.

AAFES Strengths

o Distribution of basic works well.

o Computer support is the best of the systems.

o Buyers are well educated and professional.

o New stores are very good.

Weaknesses

o Internal distribution system too costly which tends to escalate overall overhead.

o Execution of promotions in H&BA not good.

o Poor clothing merchants - overly centralized.

o Loss of customer contact with management.

SUMMARY

Most in industry believe consolidation would result in cost savings for both the military and industry. However, most of industry also believes that these cost savings could be more than offset by the long term gradual switch from the competitive retail organizations of today to a less competitive bureaucracy in the future. Couple this factor with the elimination of the patron's ability to choose which merchandise presentation they prefer (Navy, Marine Corps, AAFES) and industry generally concludes that overall exchange sales to the military will decline under consolidation. The end result will probably be less nonappropriated funds to support recreation rather than more.

There may well be some middle ground solution involving all services using AAFES distribution system for warehoused hard goods and some consumables. This could reduce the unit distribution cost of AAFES and increase the in-stock position in Navy, Marine Corps and Coast Guard retail stores. At the same time, there appears to be real value in maintaining separate service merchandising philosophies in soft lines.

The AFMC echoed similar concerns, but expressed no position on the consolidation issue.

RECOMMENDATION

24. Concerns by industry should be factored equally with other considerations in the consolidation decision.

7.14 EXCHANGE RELATIONSHIPS WITH LOCAL COMMANDS

BACKGROUND

Each military service differs in its relationship with its local exchange manager/officer as indicated below:

AAFES

The exchange manager, who is civilian, maintains an active relationship with the local command by attending staff meetings, advisory meetings, officer wives club meetings and other related events and meetings. The area general manager, responsible for multiple base exchange operations, also interacts with each local command on a fairly regular basis. Performance appraisals of the exchange manager are done by the general manager with invited input from the local command.

NAVY

The exchange officer/manager reports directly to the base commander and concurrently to the NAVRESSO field support office (FSO/NAVRESSO). The exchange officer/manager works closely with command and attends staff meetings, consumer group meetings, advisory boards, etc. He receives annually two performance appraisals, one done by the base command, and one by the commander of the FSO (NAVRESSO in the case of an independent exchange).

MARINE CORPS

The exchange officer, military or civilian, reports directly to the MWR director at each base. In the case of installations where the exchange officer is also the MWR director, he reports directly to and is evaluated by the base commander. In this scenario, as MWR director, this person has responsibility for resale activities and base recreation programs.

DISCUSSION

Arguably, the success of each exchange system's mission is dependent upon its ability to directly control the operations of their resale activities and personnel.

From a strict business standpoint, economies gained from operations can only be captured when policies and procedures can be consistently applied. Maximizing patron savings, optimizing customer service and providing a reliable source of funding to MWR, are the goals of

all three systems. There exists a potential for conflict with these goals under the present Navy and Marine Corps reporting structure. An exchange manager should be subordinate to only one reporting senior, acknowledging however, that he is responsible to others.

On July 18, 1990 and August 2, 1990, Focus Group sessions were held with representative installation commanders and senior enlisted advisors from each service respectively. Appendices D and E are minutes from those sessions. The overall comments from both groups were:

- The general consensus was for maintaining the present system and not to consolidate.

- While most commanders did believe savings could be realized with consolidation, they did not believe centralization to be an answer.

- Each service exchange system was satisfying their command's mission needs.

- Both groups believe that their current command and exchange communication channels were adequate.

- All believed that savings at the exchange and a viable and financially healthy on-base MWR program is not mutually exclusive.

RECOMMENDATIONS

25. The operations, technical control and professional guidance of an exchange should be directly controlled by the exchange system.

26. Base commanders should have input into an exchange manager/officer appraisal.

7.15 AAFES CATALOG SALES DIVISION

BACKGROUND

Catalog Sales is a division of the Marketing Directorate in AAFES Headquarters, Dallas, Texas, responsible for the entire worldwide catalog operations.

The Catalog Sales Division operations consist of a central office in Dallas with the executive office, a customer service branch, and a merchandising and marketing branch. Catalog operations located outside of Dallas consist of three warehouses in the Pacific (Japan/Korea/Philippines), one warehouse in Europe (Germany), and one warehouse for American items in Atlanta, Georgia, with an additional 220 U. S. suppliers shipping the merchandise directly to the customer. Three group chiefs with their office staffs are located in Giessen, Germany; Atlanta, Georgia, and Yokota AB, Japan.

Exchange catalog orders from authorized customers worldwide are mailed or phoned in to the catalog sales office in Dallas where they are processed the same day. The next workday, individual electronically transmitted picking tickets are printed out at the shipping location, or are mailed to shipping locations for the direct-ship suppliers in the United States. Warehouse personnel locate the merchandise based on the picking ticket information, place the packages into the postal system or UPS (Atlanta) and then electronically report such action back to Dallas. The customers are then notified of the status of their order. A backorder system exists at customer option. To enhance customer satisfaction every effort is made to keep the customer informed, be it through the mail, phone or at the nearest exchange activity.

Merchandise included in the catalog is based on the best selling items in exchange stores around the world, new items found at the various merchandise shows in the U. S. and Europe, and through buying visits to foreign countries.

Until 1988, the catalog had three distinct sections - American, Europe and the Pacific. These separations were directly related to the major theaters of operation of military customers, and were intended to make their shopping easier. Each group chief was responsible for his particular section of the catalog and its performance. Through 1987, the catalog was printed each year in two separate editions - one for

the overseas customers and one for the Continental United States (CONUS) customers. This was necessary due to item and sell price restrictions on merchandise that could be sold in CONUS; certain restricted overseas merchandise could not be sold to the CONUS customer. In 1988, the two editions were consolidated for the first time and one catalog was issued worldwide with those items not authorized for sale in CONUS clearly identified.

The Exchange Catalog Program is the only one of its kind for non-military items in the military services, and it is available to all personnel in the Army, Air Force, Navy, Marine Corps, Coast Guard, Reserves, National Guard, U. S. Embassies and Consulates, and any other authorized customers as approved by the Department of Defense. Catalogs are distributed to nearly 4,000 locations throughout the world, including over 500 ships at sea, by mail, truck, air and water transportation.

Following are facts and statistics about the magnitude of the Exchange Mail Order Program.

o Annual sales last year (1989) were $43.2 million and earnings were $1.2 million.

o The Catalog Sales Division processed 263,200 orders and 503,000 shipments in 1989. Average value per order is approximately $164 and per shipping ticket was almost $85.

o There are about 6,232 items on 476 pages in the 1989-90 catalog, from 34 countries. 121 items are restricted from sale in CONUS. The 1990 Spring edition contains 2,841 items, 26 restricted from CONUS sale.

o In 1989 AAFES printed 850,000 retail catalogs and 50,000 complimentary catalogs. The Spring 1990 edition is 595,000 retail and 55,000 complimentary editions.

o There are 218 employees in the Catalog Sales Division, located as follows:

Dallas, TX	109
Atlanta, GA	40
Giessen, Germany	19
Yokota AB, Japan	39
Seoul, Korea	4
Clark AB, Philippines	7
Total	218

It takes an average of 3 to 9 days to receive and ship a catalog order by catalog warehouse, and it takes from 15 to 75 days for the postal system to deliver the merchandise to the addressee on the order. Direct delivery shipments may require 7 -10 more days to fill.

In 1989 the Catalog Sales Division filled 91.5% of all orders received within 30 days. Mail order warehouses fulfill 94.4% of their orders within 30 days.

In order to obtain the items in the catalog, catalog sales personnel and AAFES buyers attend merchandise shows in England, Italy, Spain, Switzerland, Germany and throughout the United States. In addition, they shop the markets throughout the Pacific in such countries as Singapore, Thailand, Hong Kong, Taiwan, Philippines, Japan and Korea.

In order to ship customer orders in the most expeditious time possible, the five warehouses stock over 7,000 items and maintain an average inventory balance of $9.0 million per month.

The catalogs are offered for sale worldwide at AAFES and other services' facilities for $2 and $3 and a coupon good for $3 - $5 off the first order is included in each catalog. Redemption cards (good for free catalog) are mailed to all customers who placed an order the previous year. The cards are redeemable at any exchange, or by mail if not near an exchange.

Free distribution of catalogs is made to multi-use locations at a ratio of one catalog per every 15 - 20 people served. This procedure has been followed in the past for ships at sea, and isolated sites where catalogs are shared and not available for sale to individual customers. Free catalog distribution is made to Embassies, consulates and other authorized agencies that do not participate in the catalog earnings.

To speed service, customers enrolled in the Defense Eligibility Enrollment Reporting System (DEERS) have the option of ordering toll-free by phone or by FAX. The orders must be charged to Visa, MasterCard, or Discover credit cards. There is a separate toll-free number for inquiries, whereby customers can ask about the status of their order or claim quickly and easily.

Telephone orders accounted for 32.4% of all orders, a 124% increase over 1988. Over 60% of the U. S. based customer places their orders by phone or FAX.

DISCUSSION

This consolidated catalog program which supports all services, impressively fulfills the primary mission of the exchange systems, providing authorized goods and services at the lowest practical cost. With the expected loss of patron base due to troop drawdowns, consideration should be made to develop the number of reservists, retirees and other authorized patrons who are not presently using the mail order catalog.

RECOMMENDATION

27. The catalog sales program should aggressively pursue its authorized patron base.

TABLE 7-5
SHIPS STORES PROGRAM

	FY 88	**FY 89**
Number of Stores	376	362
Sales (Millions)	$131.3	$129
Profits (Millions)	$ 18.8	$ 18.4
Avg. Inventory (Millions)	$ 24.3	$ 24.2
Stock Turns *	4.56	4.17

* Stock turn goal is 4.0 turns per year.

7.16

NAVY SHIPS STORE AFLOAT PROGRAM

BACKGROUND

The Navy Ships Store Afloat Program managed by the Navy Resale Program is an Appropriated Fund activity that serves men and women aboard Navy ships. These stores provide a selection of basic merchandise, gift items and some higher priced merchandise such as watches, cameras and stereo's for purchase by the ship's crew. Ships store also operates services such as ice cream bars and vending machines aboard ship, including electronic game machines for amusement of the crew during off-duty time. Though they are appropriated fund activities, they are authorized to make a profit, which helps support shipboard recreation and general Navy recreation programs. Additionally, money generated through sales in a ship's store support services which are provided free to the crew laundry and dry cleaning, barber shops and tailor shops. Table 7-5 indicates that the Ships Store Program is financially significant and sound.

MANNING

All ships stores are manned by the shipserviceman enlisted rating. This specialty rating provides the manpower for the myriad of services offered by an onboard ships store division (barber Shop, laundry and dry cleaning, tailor shop, vending, amusements, stockrooms, recordskeeping, ship's store, snack bars, and cobbler shops). Normal career path rotation is from a ship to a Commissary or Exchange ashore. There are at present 103 ships stores positions authorized.

PURCHASING PROCEDURES

The Ship's Supply Officer or an appointed Ship's Store Officer supervises and initiates the purchasing for the ships store based on the crew's demand and inventory limitations. Authorized items and cost limitations are within the listings of authorized items for sale in Navy Exchanges as defined in the Armed Services Exchange Regulations.

Popular basic items of ships store stock are included in contract bulletins; popular luxury and semi-luxury items are listed in the Ships Stores Afloat Catalog, published by the Navy Resale and Services Support Office.

Items not listed on Contract Bulletins or the Ships Stores Afloat Catalog may be offered for sale to ships stores. Prior to offering the items, it must be presented to the Ships Stores Division at NAVRESSO for review and determination of quality and value.

New items are normally approved when the item is a nationally known brand name product of proven popularity, or in the case of lesser known items, after samples are examined by NAVRESSO for quality and value assurance. Suppliers are required to submit a letter from the manufacturer stating that the supplier is the appointed representative for the product submitted. The manufacturer's published price list, minimum order requirements, terms and delivery schedules should also be submitted with the item.

If the quality/value analysis determines the product to be acceptable, it is approved for sale to ships stores for a nine-month period. During this time, ships desiring to purchase the product will submit a purchase order to the nearest NAVRESSO fleet assistance representative, who will process the order. Fleet assistance reps are located in major port areas. The supplier will be required to meet the quantities and delivery date specified in the purchase order. There are currently two procedures for paying dealer's bills for merchandise ordered by Ships Stores Afloat. One method is using the "Fast Pay" procedure. Under "Fast Pay", dealers submit their invoices directly to the paying activity with the original purchase order and proof of shipment/delivery documents. The other procedure is for the dealer to submit an original and three copies of the invoice to the ordering ships, where it would be certified as to receipt and acceptance of the material and forwarded to a Navy paying activity for payment of the bill.

At the conclusion of the nine-month period, suppliers will be asked to submit copies of processed ships purchase orders for the items to NAVRESSO. A determination will be made on whether to continue the supplier's authority to sell to ships stores based on the volume of business and the crews' acceptance of the product.

The items may be considered for addition to the Contract Bulletin or the Ships Stores Afloat Catalog if there is sufficient evidence of bona fide recurring demand in various geographical areas. Reorders, not one-time purchases, are considered recurring demand.

DISTRIBUTION

Orders for items from the contract bulletins or Ship's Store Afloat Catalog purchase orders are submitted directly to the contract. Contracts for necessity items require delivery to the afloat unit within 24 to 72 hours. This allows ship's store to reduce conflicts with unanticipated operational commitments.

DISCUSSION

The Navy Ships Store Afloat Program is a unique resale entity that provides vital quality of life services to men and women aboard ships and provides a career program for a specialized cadre of Navy enlisted persons. While the technical guidance and administrative support may be provided within a consolidated environment, onboard operational decisions should remain the responsibility of the ship Commanding Officer. Additionally, given the arduous nature of normal ship operations, the profits generated from ships stores should be left available for onboard MWR activities.

RECOMMENDATION

28. The Ships Store Afloat Program should be allowed to operate under its present guidelines.

29. A viable career path for Navy shipservicemen must be maintained.

7.17

MILITARY CLOTHING SALES

BACKGROUND

Unquestionably, the Services responsibility to ensure that it's military members are properly outfitted with uniform articles is of paramount importance.

To satisfy service members needs, military personnel have the option to purchase military clothing that is procured through Defense Personnel Support Center (DPSC), Philadelphia, or commercially procured items which are available only through their respective exchange services. Items from DPSC are sold or issued at cost price, while commercial - type clothing contain a standard exchange markup.

Review of each Services' military clothing procedures indicate a wide variation as to degree of involvement of the exchange systems.

NAVY

NAVRESSO in 1976 was named the Uniform Program Manager with oversight management responsibilities for all uniform assets at DPSC, Naval Supply Centers/Depots, Recruit Training Commands, Navy Resale Activities, and Ships Stores Afloat.

NAVRESSO's involvement begins when the Uniform Board initiates a tasking for a new uniform item and ends when the item is disposed of out of the system when no longer required by the Navy. This conception to grave lifecycle management, includes command of the Navy Research Clothing and Textile Facility at Natick, Massachusetts. Navy Resale provides demand forecasts to DPSC for all Navy requirements including Reserves, NROTC and NJROTC. NAVRESSO directs redistribution between RTC'S and Naval Uniform Centers, manages the excesses and directs inventory mix. This has allowed the Navy to maintain 100% full initial uniform allowance for graduating recruits.

The Uniform Support Center in Norfolk, VA provides a central twenty-four hour/seven day a week telephonic or mail order service for all Navy members worldwide. It ships expeditiously uniform articles and serves as the single

consolidation point for obsolete commercial items.

AAFES

AAFES has assumed from the Army and Air Force management responsibility for their Military Clothing and Small Stores (MCSS). These 252 resale outlets sell both items obtained from DPSC and commercial sources. They work closely with DPSC and their appropriate research laboratory, but do not have the oversight management responsibility for these two activities or their inventories. The outfitting of new recruits, and stocks held at the recruit training commands is a function of the Army or Air Force, with minimal involvement with the Exchange System. Military members located at remote sites can either call or mail orders to nine exchange sites which will forward the clothing item to the customer.

MARINE CORPS

Since 1981 the Marine Corps exchange service has operated Military Clothing Sales Stores (MCSS) at eleven commands. Responsibility for the remaining Marine Corps bases is with the on-base supply department. The Marine Corps MCSS provide a full range of DPSC procured enlisted military clothing and in several of those stores commercially procured products. Women Marines and officers located at remote sites must utilize Quantico Marine Corps Base for mail orders, while male enlisted members must use either Camp Lejuene or Camp Pendelton. Working with the Marine Corps Uniform Board and the quality control personnel at MCB Albany, Georgia, the Marine Corps exchange system provides assistance as required regarding uniform matters.

RECOMMENDATION

30. The Navy Clothing and Textile Research Facility should be transferred internally within Navy under a total consolidation.

CHAPTER 8

FOOD OPERATIONS

OVERVIEW

The military exchange systems operate 2,700 food facilities around the globe. Facilities include name brand fast food franchises, cafeterias, snack bars, mobile units, refreshment stands, ice cream shops, delicatessens, sandwich shops, specialty restaurants, and school meal lunch programs.

In FY 89 the three systems generated exchange food sales of $815.6 million. Reviewing the industry top 100 restaurant chains ranked by sales (as published in Restaurant Business Magazine, November 20, 1989), the exchange systems, as a combined entity would rank # 15. As individual entities, two of the three systems would rank: AAFES # 24 with sales of $576.4 million and NEX # 68 with sales of $187.4 million. It is interesting to note that in 1988 the top 100 restaurant chains generated 47.5%, or $63.3 billion, of the total eating places sales of $133.3 billion. Needless to say, the exchange systems sales place them in the "Big Business Category."

The soldiers, sailors, airmen, and marines come to the military

resale market conditioned by experiences in the commercial market. The primary and predominant portion of the customer base (18 - 34 years old) grew up patronizing major fast food chains in the hamburger, pizza and chicken segment of the market, i.e., McDonalds, Burger King, Pizza Hut, Dominoes, Kentucky Fried Chicken, Popeyes, etc.

As indicated by the data in Figure 8-1 and 8-2, the fast food category of the food business continues to lead the surge in growth.

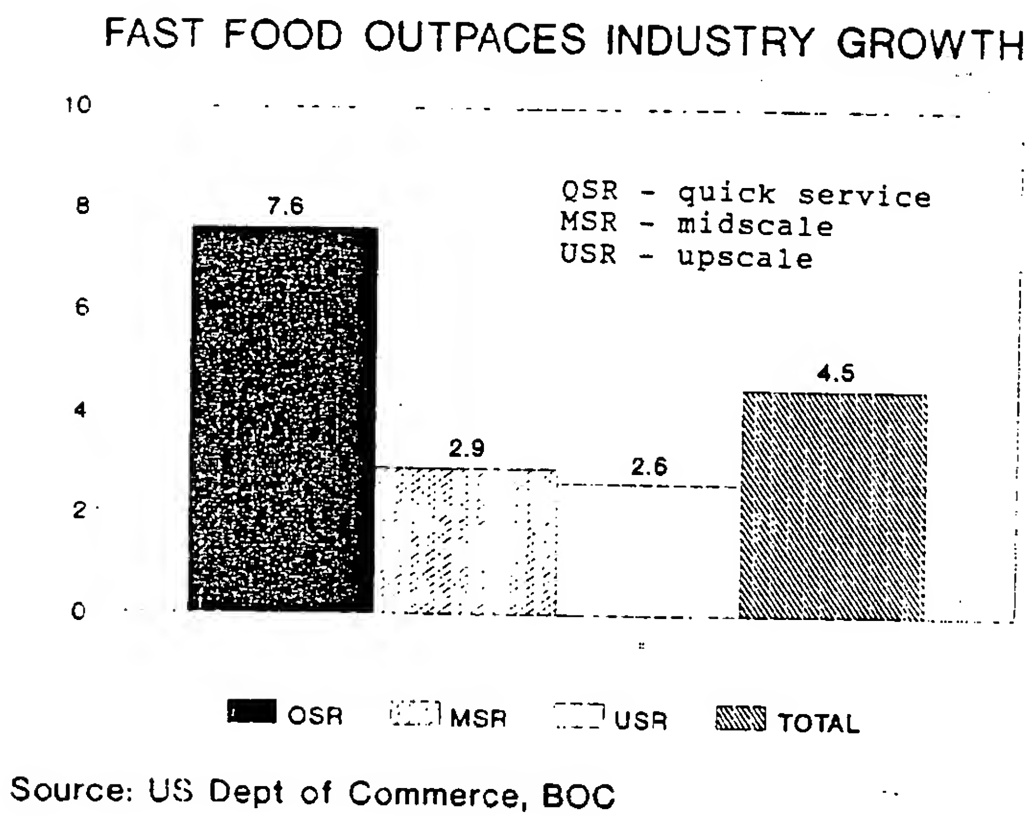


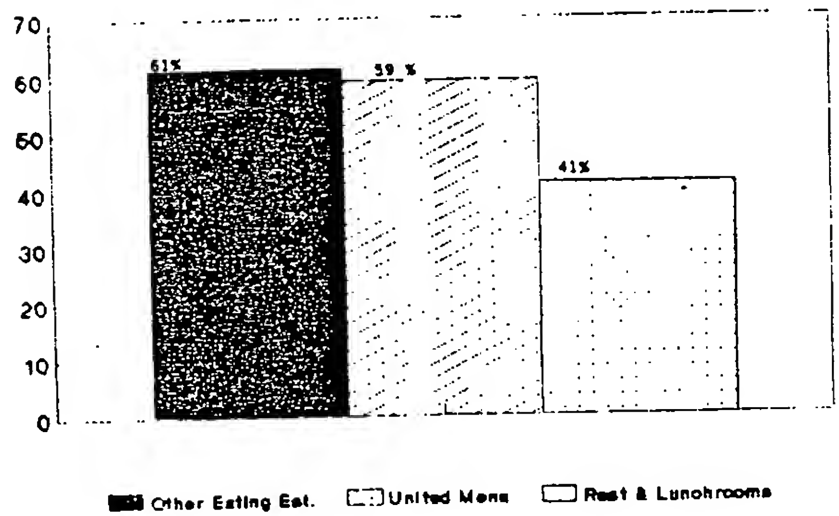
Figure 8-1

Nominal Growth in Retail Sales
1989 vs. 1988

1989 was a slow year, with relatively weak nominal growth in all segments but fast food. Restaurants posted 2.9% nominal sales growth (a decrease of 1.6% in real terms, factoring out inflation of 4.6%). Fast food was the winning growth segment, with a nominal sales increase of 7.6% and real growth of 2.9%.

This helped steady eating and drinking place sales to 4.5% nominal growth (0.0% real). The forecast calls for some improvement in 1990: Restaurants predicted 1.0% real growth, combined with a healthy 3.0% jump for fast food, which should drive the industry into modest 2.0% real growth.

SALES/THE TYPE OF EATING ESTABLISHMENT
PERCENT CHANGE 1983-1987



SOURCE: 1987 Census of Retail Trade

Figure 8-2

Within the fast food franchising category, sales have grown from $43.4 billion in 1984 to $69.1 billion in 1989. Sales growth by each major segment during the 84 - 89 period is shown in Figure 8-3.

Restaurant Franchising
Growth in Sales 1984-1989
(Sales: $000)

Major Activity	1984	1989	% Change
Chicken	$ 3,891,165	$ 5,146,744	32.3
Hamburger, Franks, Roast Beef	22,043,955	34,442,872	56.2
Pizza	4,932,329	10,278,107	108.3
Mexican	2,113,104	3,101,192	46.8
Seafood	1,074,426	754,358	(29.8)
Pancake, Waffle	985,350	1,404,720	42.6
Steak, Full Menu	7,767,393	12,183,216	56.9
Sandwich, Other	626,060	1,782,899	184.8
Total	$43,433,782	$69,094,108	59.1

Source Restaurant Business Magazine, March 20, 1990

Figure 8-3

The demographics in the commercial sector continue to show the change toward food away from home. Home life, working women, single parents and time restraints of the 80's will continue in the 90's. The National Restaurant Association's annual 1990 forecast report states "off premises phenomenon clearly has become an American way of life that is even more popular among younger adults." While overall industry customer traffic 1989 vs 1988 was up 0.8%, take-out has clearly been driving customer counts (Figure 8-4).

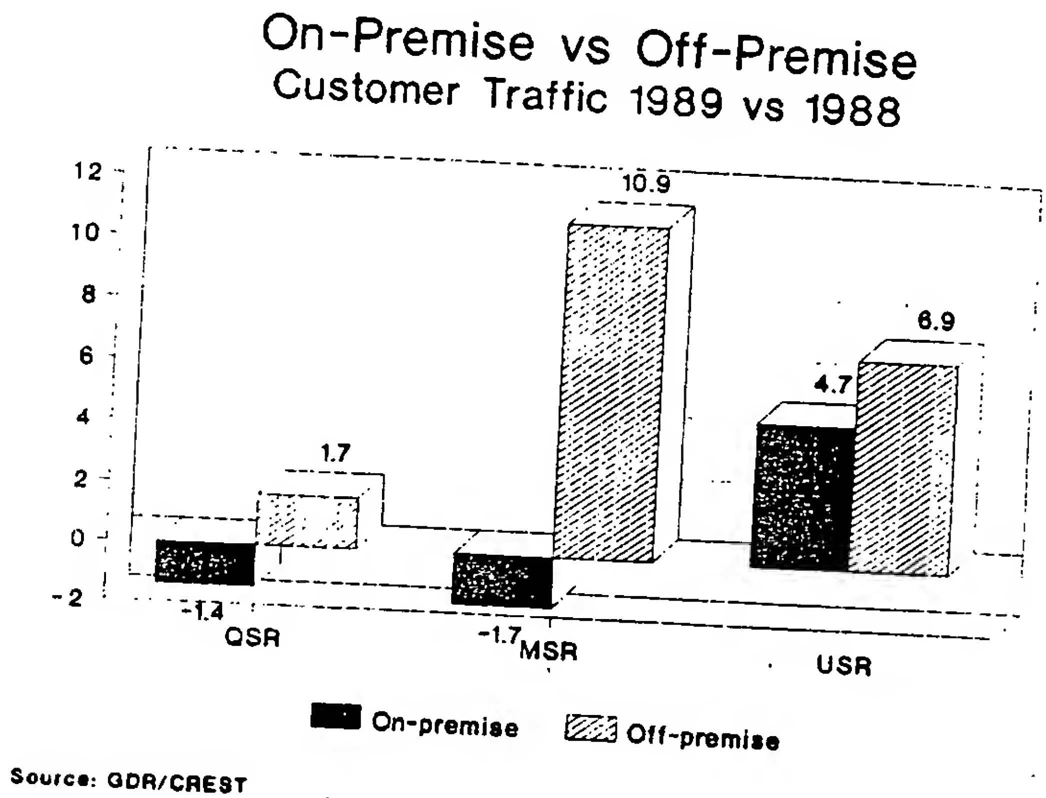


Figure 8-4

In the quick-service segment, less than 40% of all customers eat on-premise: off-premise dining grew by 1.7 percent, while on-premise dropped by 1.4 percent. The trend was even more apparent at midscale restaurants, where on-premise dining declined by 1.7 percent but take-out traffic jumped 10.9 percent versus a year ago.

Off-premise dining now represents more than 16 percent of traffic at midscale restaurants. Upscale operators enjoyed both a 4.7% increase in on-premise and a 6.85% rise in take-out.

Off-premise, however, represents only 7 percent of all traffic at upscale restaurants.

One of the big issues facing the food service industry in the 90's is consumer interest in the relationship between diet and health. In the next decade we'll have more confirming information about the close relationship between diet and health. The food industry will respond to the challenge with many alternatives. How individual companies respond will impact on sales and earnings. The military customer will expect the exchange services to be at least equal to the major industry leaders in providing more alternatives.

The military exchange services have, for the most part, taken advantage of the fast food surge of the 80's. All three systems implemented major name brand fast food (NBFF) franchise operations in the dominant hamburger segment. As of Jan 90 the military exchanges have 205 hamburger franchise operations generating total FY 89 sales of $297.3 million.

The challenge of the 90's will require the exchange services to expand food service into other segments of the fast food market and recognize the changing customer lifestyle in terms of the upward trend in food eaten away from home.

The review of food operations that follows will provide a look into the current status of each system's food programs, financial and customer service results and how each plans to meet the challenges during the 90's.

Due to the time constraints, the approach to the review was macro in nature. All information, data, business plans and financial results were reviewed on a "consultant services" method, e.g., if sales data showed a negative and/or positive trend, then an effort was made to find the "why". In some cases the differing accounting systems and financial statements made comparisons difficult, or in some cases, impossible.

Two focus group meetings were held with representatives from each exchange system in attendance. Each representative provided overviews of current and planned business strategies.

ORGANIZATIONAL PHILOSOPHY

The organizational philosophy regarding headquarters responsibility for food operations differs significantly among the services. AAFES food programs and concepts are centrally developed, directed and monitored. All policies, operating procedures and facility concepts are mandatory at the operating level. Day-to-day operational management of food operations is, however, decentralized. For example, AAFES markets pizza under the "Anthony's Pizza, The World's Greatest" restaurant concept. If local installation management identifies sales, profit and/or customer service potential for a pizza facility, then the product and

facility must be marketed under the Anthony's concept.

In contrast, NAVRESSO, with the exception of the centrally developed and administered concession McDonalds contract, provides field elements overall policy and procedure. Central food concept development and subsequent direction have not been a primary function of the NAVRESSO. Field operations are totally decentralized. For example, if local installation management determines a pizza operation is required, the type and nature of operation is developed locally.

However, current NAVRESSO business plans include a commitment of resources to centrally develop and implement in house food franchising concepts.

The Marine Corps MWRSPTACT headquarters provides the local installation policy and procedural guidance. Field operations are totally decentralized with no plans to centralize any food concepts.

CURRENT STATUS

The three systems in FY 89 generated combined food sales/ profits of $815.6 million and $103.5 million respectively. A breakdown by system is in Figure 8-5.

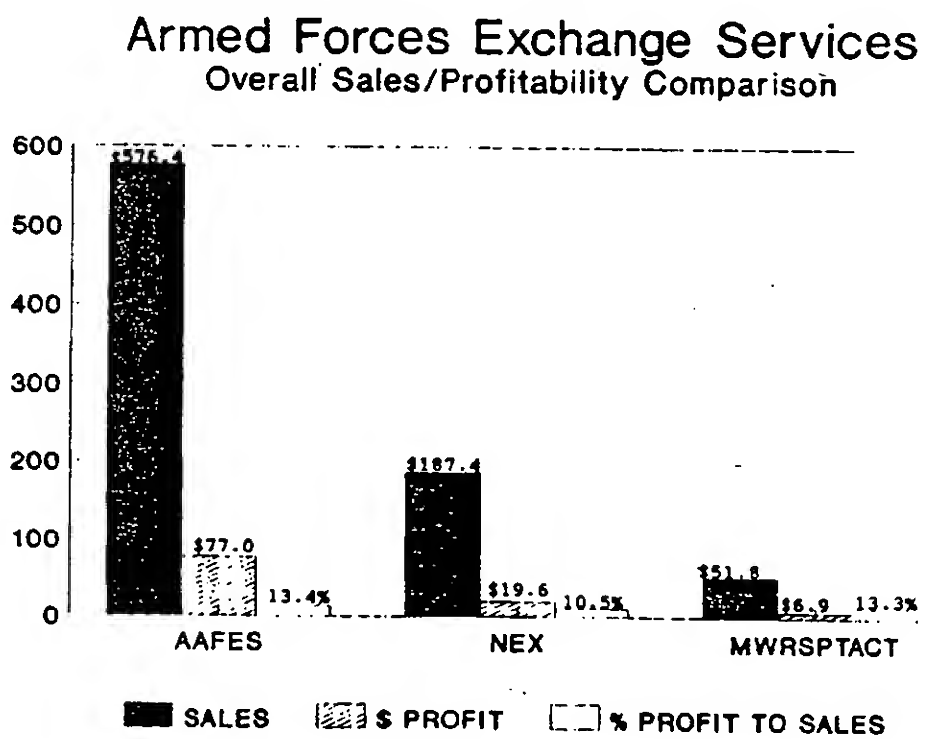


FIGURE 8-5

In reviewing the FY 89 data the following rankings emerged:

Ranking	Sales	$ Profits	% Profit to Sales
# 1	AAFES	AAFES	AAFES
# 2	NEX	NEX	MWRSPTACT
# 3	MWRSPTACT	MWRSPTACT	NEX

From a strict numbers standpoint, the AAFES and MWRSPTACT are approximately equal in terms of FY 89 percentage profit to sales. The NEX's percentage to sales is 2.9% below the AAFES/MWRSPTACT. Using the percentage to sales result as a comparative efficiency measurement, then the NAVRESSO dollar profit fallout factor compared to AAFES/MWRSPTACT is $5.5 million. (See Attachment 1, Appendix F). To further identify trends, sales and profits were plotted for the FY 87-89 three year period in Figure 8-6 and 8-7 and analyzed in Figure 8-8.

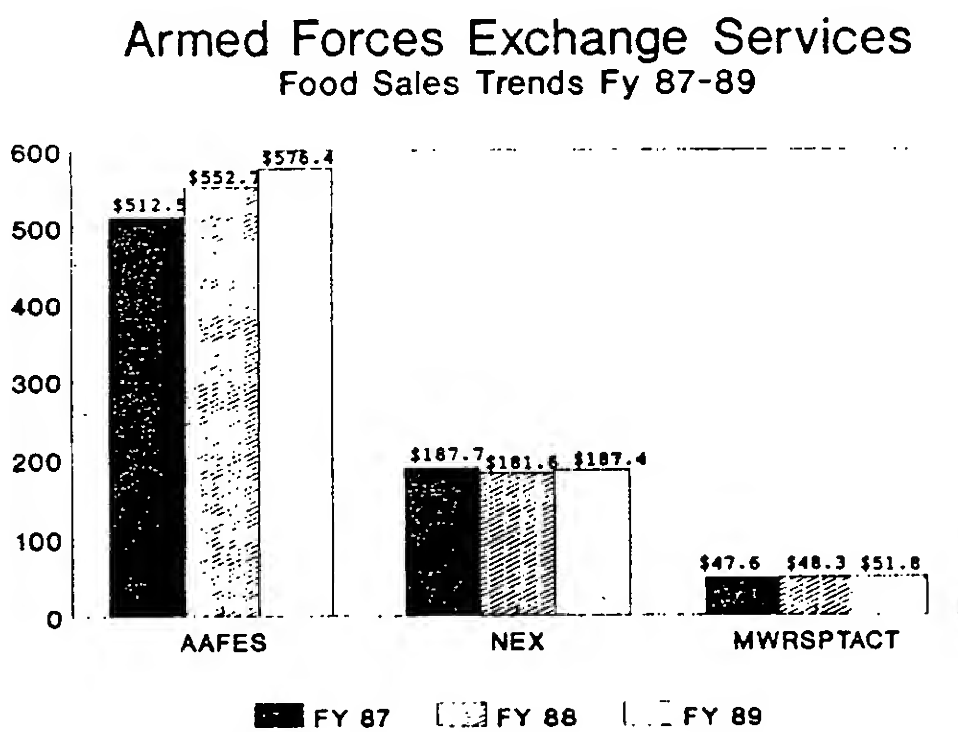


Figure 8-6

Armed Forces Exchange Systems
Food Profit Trends FY 87-89

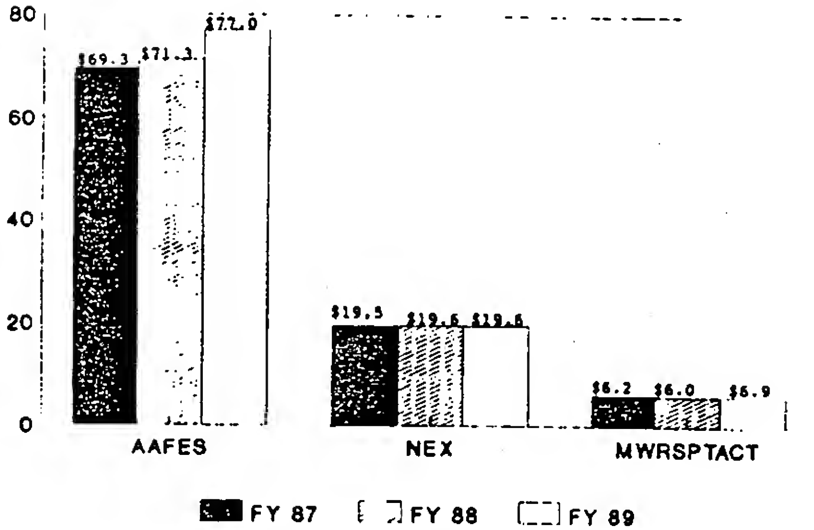


Figure 8-7

TREND ANALYSIS

Cumulative Sales Increase/Decrease
FY 88-89 to FY 87 (Base)

AAFES	- increased	$63.9 M	- 13%
NEX	- decreased	.3 M	- .2%
MWRSPTACT	- increased	$4.2 M	- 9%

Cumulative Profit Increase/Decrease
FY 88-89 to FY 87 (Base)

AAFES	- increased	$7.7 M	- 10%
NEX	- increased	.2 M	- .1%
MWRSPTACT	- increased	.7 M	- 11%

Figure 8-8

METHOD OF OPERATION

The three systems operate their food facilities directly and by concession. The ratio of direct versus concession sales varies significantly. As indicated by Figure 8-9, AAFES has a much higher percentage of direct food operations than Navy or Marine Corps.

RATIO OF DIRECT/CONCESSION SALES/PROFIT BY SYSTEM

	FY 89 Sales ($ M)	Ratio	Profit ($ M)		%	Ratio
AAFES						
Direct	$563.7	97.8%	$74.9	-	13.28%	97.3%
Concession	12.7	2.2	2.1	-	14.63	2.7
Total	576.4	100.0%	77.0	-	13.36	100.0%
NEX						
Direct	82.1	43.8	9.0	-	10.96	45.9%
Concession	105.3	56.2	10.6	-	10.07	54.1
Total	187.4	100.0%	19.6	-	10.45	100.0%
MWRSPTACT						
Direct	22.2	42.9	2.9	-	13.06	42.0%
Concession	29.6	57.1	4.0	-	13.51	58.0
Total	$51.8	100.0%	6.9	-	13.32	100.0%

Figure 8-9

The difference in each system's method of operation has had major impact on their sales/income; capital investment in physical plant; food service employees career development; and short and long term business strategies. The primary reason for differing methods of operations traces back to each system's decision on how best to exploit the sales opportunities via hamburger NBFF franchise operations on military installations. Prior to NBFF all three systems operated most food operations directly.

Name Brand Fast Food (NBFF) - Franchise Operations

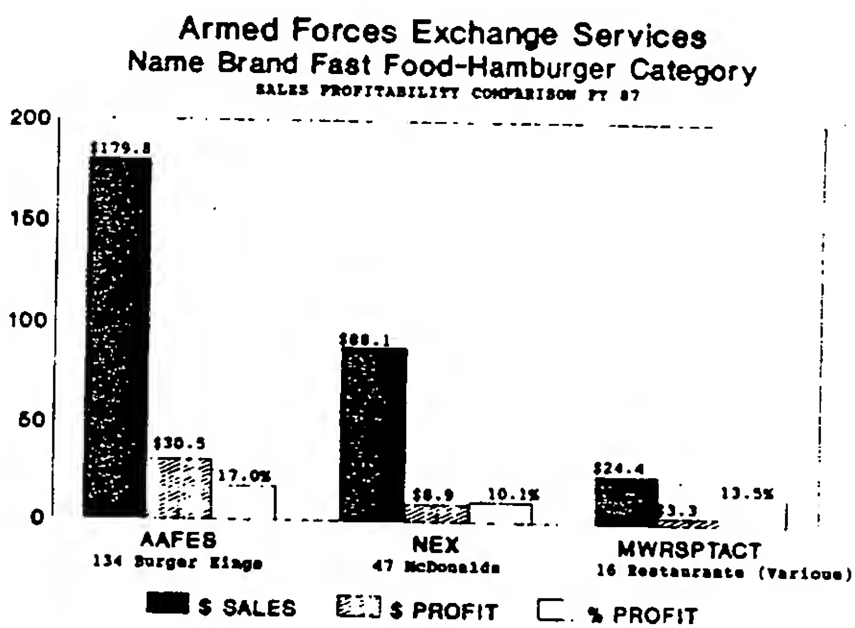
In the late 70's and early 80's the fast food industry had matured to the point where McDonalds, Burger King and Wendy's were the dominant name brand fast food franchises in the commercial sector. All three companies had multi-million dollar national advertising budgets to influence customer buying habits. The military customer comes to the military resale system conditioned by experiences in the commercial sector and expects a similar level of service. While each system was doing a good job providing the military customers quality food service, the mobile military customer did not hesitate to leave the installation to patronize the name brand fast food restaurant located outside the gate. To meet the competitive challenge in the fast food hamburger segment (largest of the fast food market segment) each system in 1984 embarked on franchise contracts with national fast food hamburger chains.

AAFES solicited the top three national hamburger chains to obtain

a franchise to operate the selected company's restaurants on a direct basis. AAFES would fund, construct, operate and staff the restaurants and pay a royalty and advertising fee based on sales. In May 1984 the contract was awarded to Burger King Corp. As the franchisee the contract called for AAFES to build and operate 180 restaurants at Army and Air Force installations worldwide.

NAVRESSO solicited the major national hamburger chains to operate, on a concession basis, fast food hamburger facilities on Naval installations worldwide (minimum of 20 up to 300 facilities during term of contract). The chain would construct, operate each restaurant, and pay the NEX a percentage fee based on a sliding sales scale. On 7 August 1984, NEX awarded a contract to McDonalds Corp.

The MWRSPTACT, rather than soliciting and awarding a concession contract to a single chain for all Marine Corps installations, decided to competively solicit each separately. The selected chain would construct, operate each individual restaurant and pay the local MWRSPTACT a percent of sales. A comparison of each system's NBFF hamburger franchise program sales-profitability chart based on FY 89 results follows as Figure 8-10.



Sales/Profitability Comparison FY 89

Figure 8-10

Figure 8-10 is intended to reflect a comparison between the AAFES direct Burger King franchise contract, NEX centrally administered McDonalds concession contract, and the MWRSPTACT's individual installation negotiated concession contracts. The

sales/profits represents 197 (96.1%) of the total 205 NBFF hamburger restaurants in operation as of January 1990.

In deciding which method of operation to use, each system considered a wide range of factors such as corporate culture; availability of capital to finance facility construction (estimated at $650,000 per store); availability of a core base of experienced exchange food managers to support a direct operated program; level of desired customer savings (concessions must charge sales tax); speed of implementation (in-house construction capability); impact on cash flow; etc.

As a result of December 1987 congressional hearings on fast food franchising, the House, in a letter dated 15 December 1987, (Attachment 2, Appendix F) provided specific guidance as to how the exchanges could franchise in the future. A summary of the key points of the HASC's guidance are as follows:

- Only Armed Services Exchanges will be the contracting authority for fast food.

- For installations that can support multiple fast food restaurants, the second restaurant will not be hamburgers.

- Concession operations will be used for all new contracts on military installations located in CONUS.

- At overseas installations direct exchange service operations will be used where possible. Additionally, one exchange system can directly operate a franchise at a military installation of another Armed Service.

- Retail pricing of fast food restaurants on military bases in CONUS will be comparable to fast food operations in adjacent communities.

Since the House guidance requires any future NBFF initiatives in CONUS be concession operations, and for overseas the preferred method is direct, the study group did not perform an analysis as to which method of operation, direct or concession, provides the best return.

The importance of the NBFF franchise program in the hamburger segment, as it relates to total sales and profitability of the food program, is illustrated in Figure 8-11:

HAMBURGER SEGMENT TO TOTAL SALES

FY 89 Sales ($ million)

System	Total	NBFF Sales	% To Total
AAFES	$576.4	$179.8	31.2
NEX	187.4	89.9	48.0
MWRSPTACT	51.8	24.4	47.3

FY 89 Profit ($ million)

System	Total	NBFF Sales	% To Total
AAFES	$77.0	$30.5	39.6
NEX	19.6	8.9	45.4
MWRSPTACT	6.9	3.3	47.8

Figure 8-11

As shown, all three systems have tapped the sales potential for the hamburger segment of the market. However, if each system is to maximize potential market share of food sales and give the customers what they want, a full complement and variety of food service must be provided. As Figure 8-11 indicates, Navy and Marine Corps may not be maximizing sales potential in market segments other than hamburgers.

Other Food Programs

A summary of each exchange system's plan to tap potential sales in pizza, chicken, franks, mexican, sandwich and sweet goods segments of the market follows:

AAFES

The AAFES business plan for capturing sales in other than the hamburger segment involves three different strategies. First, in - house developed food concepts worldwide; second, direct franchise NBFF overseas; and finally, NBFF concessions in CONUS.

In 1986 AAFES made a business decision to pursue development and implementation of in - house food concepts. This program effort was prompted by success and lessons learned from operating the direct Burger King franchise restaurants; the need to transfer the same success in terms of sales, profits and customer service to the other segments of the food market; and to address Congressional concern, as a result of constituents (local business community) objections to the military exchanges entry into the hamburger business on a franchise basis.

As a result, AAFES developed its programs with the intent of marketing and operating each food concept as if it were a commercial franchise operation. Each concept, would have a standard name, decor, image, product delivery system, menu, operating procedures, packaging, training and

advertising/promotion. All restaurant units would undergo a vigorous initial licensing review by HQs AAFES Marketing Directorate Staff, followed by periodic restaurant progress reports. Non-adherence to standards would result in withdrawal of the approved license. Figure 8-12 shows the six programs that have been developed. All concept names have been registered for trademark purpose.

AAFES IN - HOUSE FOOD CONCEPTS
Figure 8-12

Category	AAFES In-house Program	Rollout/ First Unit Activation Date
Pizza	Anthony's Pizza The World's Greatest	April 87
Sandwiches	Robin Hood Deli & Sandwich Shop	August 87
Franks	Frank's Franks	January 88
Mexican	La Casa De Amigos	March 89
Chicken	Chicken Loft	August 90
Sweets	Sweet Reflections	August 90

Figure 8-13 shows YTD May 90 actual sales/direct operating profit results for units open.

In - House Concepts - Financial Results

Concept	# of Units	YTD May 90 (M $) Sales	Profits After Depreciation		
Anthony's (1)	120	$13.4	$4.0	-	29.9%
Robin Hood's (1)	20	1.8	.4	-	23.3
Frank's Franks (1)	69	2.1	.6	-	27.4
La Casa (1)	8	.7	.1	-	14.0
Chicken Loft (2)	-	-	-		-
Sweet Reflections (2)	-	-	-		-
	217	$18.0	$5.1		28.33

Figure 8-13

(1) Anthony's, Robin Hood's, Frank's Franks and La Casa reflect actual YTD May 90 results.

(2) First Chicken Loft and Sweet Reflections facilities were activated at Ft. Rucker and Sheppard Air Force Base in August 90. As of May 90 38% of the units programed have been activated. Full implementation will continue thru the 1990 - 92 time period. Sales and Profits from the in-house program are expected to peak at $147.6 million and $40.4 million annually.

In September 1989, AAFES competitively solicited the major chains in the chicken segment of the market (Popeyes, Kentucky Fried Chicken and Church's Fried Chicken) for a franchise to operate the chains' restaurants in the overseas market. In September 89 a contract was awarded to Popeyes. The franchise agreement called for AAFES to construct and operate, on a direct basis, 19 Popeyes restaurants (12 in Europe and 7 in the Pacific).

Sales are projected at $30.0 million annually. (Sales projections and number of unit locations have been reduced as a result of the announced troop reductions in the European theater).

Since the DoD announcement, on force reductions, AAFES has worked very closely with the Popeyes Corporation to develop a low-cost relocatable building to use in lieu of constructing new facilities. This will allow AAFES to get into business faster and at a lower cost, maximize quick return on investment and payout, and most importantly, in those locations impacted by troop reduction, deactivate and relocate the units to new business locations.

As previously indicated, any new NBFF initiatives in CONUS must be via the concession mode. AAFES competitively solicited and awarded, in January through May 89, eight contracts (six Popeyes and two KFC) for chicken restaurants and one pizza home delivery service (Dominoes).

The results and future expansion of these NBFF concession initiatives will be evaluated once operational data is available.

NAVRESSO

NAVRESSO does not plan to expand, via NBFF central headquarters concession contracts, into other market segments. However, at the local level, installation exchanges have completed local name brand fast food concession contracts as of January 1990 as follows:

Dominoes	1
Little Ceasar's	2
Pizza Hut	1
Pizza Inn	1
Subway	1
Del Taco	2
Popeyes	2
Total	10

The current NAVRESSO business plan does, however, include a strategy to develop in-house food concepts to tap the sales potential in those segments of the market. NAVRESSO, according to the information provided, is in the process of allocating the resources necessary to develop and roll out the concepts. (A copy of a NAVRESSO briefing is explaining their in - house food plans at Attachment 3, Appendix F)

MWRSPTACT

As previously indicated, the Marine Corps Exchange and MWR operations are consolidated in a single organization. Present business strategy includes the integration of club and other food activities (exchange direct operated food facilities) and

consolidating facilities and management where necessary. A major program initiative currently being developed is to centrally select a name brand fast food pizza home delivery service. The solicitation package is expected to be released in the near future. At the present time MWRSPTACT does not plan central expansion of NBFF concession initiative, other than pizza home delivery. However, under the decentralized organizational philosophy, several local installations have contracted with Subway to support the sandwich segment, eg., Camp Lejeune.

AUTOMATED BUSINESS SYSTEMS RESOURCES

Food Point of Sales Systems (FPOS) are a major management control tool at the store operations level. The ability to analyze sales, calculate and control food cost, manage inventory investment and schedule labor are critical in a cost sensitive, "every penny counts" business. Almost every major commercial food chain has an FPOS management control system in place. A summary of each exchange system status or FPOS follows.

AAFES

AAFES has two major systems to support store level food operations, a Food Point of Sales (FPOS) and a Food Operations Control and Information System (FOCIS). There are currently 153 FPOS systems installed with an additional 17 scheduled for FY 90. The Food Operations Central Information System (FOCIS), an older version of FPOS, is installed at 117 locations. A detailed description of both the FPOS and FOCIS systems is provided at Attachment 4, Appendix F.

NEX

NEX does not have a FPOS system in place. A FPOS system is under consideration, however, with system specifications having been developed and potential suppliers identified. Naval Air Station, Orlando has been identified as a test site. Pending outcome at this test, systemwide implementation is scheduled for FY 91.

MWRSPTACT

There is no FPOS system in place to manage direct food operations with none under development.

POTENTIAL RESOURCE EFFICIENCIES

As identified in the current resource review, AAFES has in place six fully developed in - house food concepts: Anthony's Pizza, The World's Greatest; Frank's Franks; Robin Hood Sandwich Shoppe & Deli; La Casa De Amigos; Chicken Loft; and Sweet Reflections. Each program is operated just like a commercial franchise operation. To develop and bring a program to full implementation stage, AAFES estimates the one-time average development cost of approximately $300,000 per program or a total cost of $1.8 million for the six programs. Although NAVRESSO and Marine Corps were asked to provide cost estimates for their concepts, they decided to go with AAFES estimates. NAVRESSO did ask that the following statement be included "It is the Navy conclusion that the $1.8 million is a one-time development cost for food concepts, however, this is not necessarily a duplicative effort in as much as positive research towards other concepts is underway." A breakdown of the development cost calculation is at Attachment 5, Appendix F.

The average time to develop a concept for presentation to field operators is six months. Site identification, funding, construction and evaluation of initial prototype units requires an additional six months.

As identified in the current resources review, the NEX business plan includes development of similar type food concepts. There is no reason to assume that NAVRESSO will not experience similar cost and time factors.

It is assumed that under the full consolidation alternative a decision to expand the existing developed, "paid for" and successful AAFES in house concept to Navy and MWRSPTACT installations would be the practical business strategy. Additionally, implementation could start relatively early in the consolidation schedule.

New Income Opportunities

The potential for sales growth in the pizza, chicken, mexican and sandwich segments is clearly validated by commercial market trends and AAFES results. NAVRESSO has recognized this potential via current business plans which call for the development in - house food concepts for each of the market segments.

It is the opinion of the study group that if in-house food concepts are expanded to Navy and Marine Corps installations, potential sales of $35 million (incremental sales increase of $17.5 million) with increased profit of $7.7 million are possible. The projection is based on 200 concepts (140-145 units, Navy; 55-60 units, Marine Corps) and applying actual average unit sales/profit experienced by AAFES.

The sales and profits projections, as presented, are not intended to be absolute, rather to emphasize the new income opportunities available under all

alternatives; status quo, partial or full consolidation. The data quoted is not included in the overall cost benefit analysis portion of the study report.

Cost Savings

Headquarters overhead costs to support food operations under the consolidation option would be minimal. It is estimated that overall headquarters staffing could be reduced by 11 positions or $650,000. However, this savings would, for the most part, be offset by increases in area field managers to provide coverage to the larger number of installation exchanges.

SUMMARY

The three exchange systems have significantly different approaches to the food programs. The NAVRESSO and Marine Corps decision to concession major portions of their food programs, while strengthening service to the customer in the NBFF hamburger category, has weakened their ability to improve the remaining direct operations. There is limited career development programs for food service personnel.

The NAVRESSO business plan to develop and implement in - house food concepts is not without risk. It will require recruitment and training of new core management.

Current food career breakdown by systems is: AAFES 1,179 positions, NAVRESSO 56, MCX 39. The review did not assign a dollar investment for the recruitment and training of a qualified management work force. Additionally, total reliance on the concession method of operation limits corporate opportunities and options in the future. The Marine Corps, by virtue of size, is limited in pursuing improvement in direct operations. Expansion of their food program must be by concession.

AAFES, with the 97.2% of its sales generated by direct operation, has a wide range of options as to how to market its food programs in the future. Even where it is determined name brand fast food concession is the preferred option, industry knowledge that AAFES can, if necessary, execute a direct program provides leverage in obtaining higher fees.

In the category of pricing, total reliance on name brand fast food concession programs limits the ability to balance savings to the customer (i.e., policy for name brand fast food requires comparable commercial pricing). AAFES in house food concepts provide overall 15% savings.

If sales and profit trends (FY 87-89) are a measure of the level of customer service, the trends in NEX sales and profitability must be of concern. However, to reverse those trends will require a corporate committment to invest in food operations. Growth in terms of increased sales indicates a higher level of customer satisfaction.

Under the consolidated option the expected impact on customer service would be positive. With

respect to the impact on food service employees, consolidation should not result in a major reduction of manpower needs. In reality career development opportunities will increase.

CONCLUSIONS

No significant dollar cost savings in overall overhead staffing would result from consolidation of food operations.

Sales and profit increases in the 1990's will come from market segments other than hamburger, i.e., chicken, pizza, franks, sandwiches and mexican. All three systems have name brand fast food franchise programs in place for the hamburger segment.

NAVESSO's business plan to develop and implement in-house food concepts similar to existing AAFES concepts is a valid and needed program under status quo and partial consolidation options.

Under full consolidation, the cost to develop the programs is a cost avoidance, since AAFES' programs are available and in place. The estimated cost avoidance is $1.8 million.

A significant sales and income opportunity exists in expanding in-house concepts to Navy/MWRSPTACT installations.

There are no operational impediments in the procurement, accounting, distribution and management information areas that would preclude consolidation.

NAVRESSO and MWRSPTACT personnel in the food career field would benefit under consolidated system (i.e., career progression; development), by virtue of the AAFES direct food operation approach.

RECOMMENDATIONS

That the exchange systems be consolidated into the existing AAFES infrastructure to enhance total sales, profits and customer service. At minimum, consolidation would result in a one time cost avoidance of $1.8 million.

That, under a phased implementation schedule, the food category be on the front end of the schedule to take advantage of the sales opportunity.

The following list of additional information and data is provided as part of the chapter.

Attachment 1	Financial Charts, Direct, Concession Sales/Profits
Attachment 2	HASC letter dated December 15, 1987
Attachment 3	NEX, Food Briefing dated 13 July, 1990
Attachment 4	Food Point of Sales Overview
Attachment 5	Cost Avoidance Calculations

Cost Avoidance
Calculation
AAFES In - House Programs

I <u>Basis of Data Calculation</u>

- Business Emphasis Group (BEG) activated Jan 86; deactivated Jan 90.

- During period (Jan 86 - Jan 90) developed six in house concepts: Anthony's Pizza World's Greatest, Frank's Franks, Robin Hood's Sandwich Shoppe, La Casa De Amigos, Chicken Loft and Sweet Reflections.

- Program development includes decor, image, equipment and layout, menu and recipe development, packaging systems, operating manuals, training package, initial training support for prototype units, follow up changes and advertising/promotion kits.

- Cross section support from engineering, store planning, procurement and training divisions.

- Upon completion of the development cycle, to include activation of initial facilities, the programs were turned over to an operations section to maintain, monitor and update.

II <u>Cost Calculation</u>

- Business Emphasis Group
  Staffing Cost

C/BEG UA 14 (1)	- $ 75,865	
Program Mgr UA-13 (1)	- 66,940	
Program Specialists UA-12 (2)	- 107,976	
Admin Assistant UA-6 (1)	- 26,937	
Total	$277,718	
- <u>Cross Support</u> 5,200 Man hours with $26.96 per manhour = $140,192		$140,192
- Consultant Services (Industry)		$ 15,000
- TDY Implementation Costs, Site Development, Training, Video Training Shoots, Management Evaluation, etc.		$ 30,000
- Misc Costs, Publication/Printing of Concept Booklets, Admin Kits, Operating Manuals and Training Materials		$ 15,000
	Total Annual Cost	$477,910

Four Year Life Cycle x Annual Costs $477,910 = Total Four Year Costs $1,911,640 Number of Programs Developed (6) = $318,607 Average Program Development Costs.

CHAPTER 9

SERVICES OPERATIONS

OVERVIEW

Military exchange services operations are business activities whose sales and/or revenue come from areas other than categorized as traditional "retail" or "food" operations. These services operations can be direct operations (directly managed and staffed by the exchange) or indirect (contracted). Table 9-1 lists these sales areas, showing the breadth and diversity of this important segment of the total exchange business. These services operations, as authorized by the DoD Directive 1330.9, which contains the Armed Services Exchange Regulations, have been offered over the years to meet the needs of the military patron.

Although in their totality exchange services operations are big business, with total direct and concession sales of nearly $1.2 billion in 1989, the "services" category is actually a loose organization consisting of over 11,000 separate, relatively small activities.

The CEO of a major retailing chain is quoted in "Business Week" magazine as saying that running a department store is simple: You just give customers what they want. "This isn't rocket science," he explains, "it's pretty basic stuff." The article then goes on to discuss some of the major complexities actually involved in running a customer

service retail business. The quote is perhaps even more applicable to services because there are no J. C. Penney or K-Mart companies dominating, or having significant name recognition, in any of those services areas listed in Table 9-1. For example, one of the largest service areas, vending, has a major company, "Canteen." Canteen is also a commercial food service unit. The company is owned by "TW Services," which, in turn, is effectively controlled by "Coniston Partners." The point is that "services," whether military or civilian, are unique, localized, difficult to compare, "personal," and highly diverse.

Some services functions are largely seasonal and ad hoc, such as income tax preparation service, while other services take on aspects of being "mission essential" such as barber and beauty shops and laundry and dry cleaning functions. The Navy Exchange, for example, operates a laundry and dry cleaning plant at each of the three Navy Recruit Training Centers. It is probable that no local commercial plant will be able to take on the volume of business involved, and the exchange plants will have to continue to provide the service well into the future.

AAFES operates 800 theaters worldwide, 500 of which are "free admission" at remote sites. The operational costs of the "free admission" theaters are absorbed by AAFES. Ticket and refreshment sales in 1989 were $27.8 million and net earnings were $2.8 million, or 10.1% of sales. Navy and Marine movie theaters are operated by MWR and are not part of their exchange programs.

All the theater programs were operating responsively, and no changes were recommended, except that profits from AAFES operated theaters would have to be excluded from non-participating services in any exchange consolidation.

There are a total of twenty-seven staff personnel assigned at the various headquarters to oversee services operations. A consolidation could result in some personnel savings.

This review focused on the traditional areas of service and identified some unique areas of concern as well as potential new or expanded initiatives. Areas of possible cost savings and efficiencies were also explored.

TABLE 9-1

SERVICE OPERATIONS: Potential Sales Areas

Bus or Taxi Service

Barber Shop (Direct)

Barber Shop (Concession)

Beauty Shop (Direct)

Beauty Shop (Concession)

Custom Tailoring

Laundry/Dry Cleaning

Tailor (alterations) (Direct)

Tailor (alterations) (Concession)

Shoe Repair

Appliance Repair (Radio + TV)

Watch Repair

Optical (Services)

Photo/Portraits/Sketching

Flower

Rental Service

Customer owned Film Processing

Personalized Services

Rental Equipment

Specialty Services

Money Orders + Travel Cheques

Service Pickup Point (Direct)

Telegraph Service (nonflower)

Uniforms (Custom + Made to Measure)

Delivery Service

Hunting + Fishing License

Domestic Services

Books + Periodicals

Motion Picture Admissions

Vendor Catalog (OSEA)

Mail a Gift

Service pickup Point (Concession)

Miscellaneous Service

Fuel (Direct)

Fuel (Concession)

Auto Parts/Access/Oil

Labor Service

Animal Care Clinics

SCOPE OF OPERATIONS

Services Operations represent 13% of total exchange sales and 36% of operating profits. There are over 11,000 sales locations and facilities within the services category.

The monetary scope of exchange services operations for FY 89 was as follows:

	Navy Exchange	AAFES	Marines	Total
Sales ($ M):				
Direct	$215.2	$210.8	$36.0	$462.1
Concession	142.7	550.7	26.1	719.6
Total	$357.9	$761.5	$ 62.1	$1,181.7
Profit/ Commission ($ M):				
Direct	$ 54.6	$ 57.9	$ 10.9	$123.4
Concession	22.4	80.1	7.9	110.5
Total	$77.1	$138.0	$18.8	$233.9

Many of the services, such as barber shops, beauty shops, laundry and dry cleaning and tailor shops directly relate to the quality of life of the military member and family. Under a consolidation, it is imperative that the mode of operation (concession or direct) and the decision making process be flexible. Each of the three services is successful and efficient in their current managerial philosophies of operation.

Not all exchange services offer all the identified services areas, but all are aware of them and are amenable to providing the service based on patron requirements at the base location.

Contacts with the commercial sector, through meetings with ALA representatives, and discussions with AAFES and Navy Exchange personnel at the distribution center level revealed only limited involvement with services. This tends to indicate the personal and localized nature of services, and their basic non-involvement with merchandise, stock turns and other purchasing - inventory complexities. Where appropriate and feasible, there was some regional and central involvement in contracting, oversight, and assistance, but not to the degree of retailing operations.

Management staffing at the three headquarters is the equivalent of 27.5 persons. In an exchange consolidation, an assumption is made that the equivalent of 14.5 UA positions at Navy and Marine headquarters could be eliminated. Offsetting this, an additional 8 UA-13 positions would be required as "Area Services Managers". The total as computed below:

	Navy		Marines		AAFES	
	No. of Pers.	$	No. of Pers.	$	No. of Pers.	$
UA-15	0.5	45,999		-----		-----
UA-14	2	156,422	1	78,211	1	-----
UA-13		-----	2	132,370	2	-----
UA-12	4	222,629		-----	8	-----
UA-11	2	92,875	1	46,438	1	-----
UA-10		-----		-----	1	-----
UA-9 & below		-----	2	56,471		-----
Total	8.5	$517,925	6	$313,490	13	-----

Total savings: Navy equivalents:	$517,925	
Marine equivalents:	313,490	
Total	$831,415	
Total cost: 8 x UA-13 "Area Managers:" *		529,479
Net Potential Annual Savings		$301,936

* UA-13: Step 3 + 45.65% FICA and other benefits

The "savings" assumes that no additional persons would be needed at headquarters. In the event of consolidation, headquarters staffing would have to be reviewed to assure that the remaining 13 persons were sufficient to do the job.

With the broad and diverse scope of services that have evolved over the years, the exchange headquarters departments have developed a long history of cooperation and communication. Contacts between the exchange headquarters are routinely conducted to discuss various issues related to services operations.

CONCESSION AND DIRECT

The three military exchange services all have very significant services operations run directly by the exchange, utilizing exchange employees, and all have very significant operations run indirect, by a commercial activity, under an exchange negotiated contract or concession agreement. The Armed Services Exchange

Regulations authorize both types of operations, and suggest a comparison of alternative costs before determining the method of operation.

The respective headquarters have made fully supportable, but different, management decisions regarding whether to emphasize direct run or concession operations. Here are the comparisons, based on dollar volume:

	Navy	Marines	AAFES
Direct	61%	58%	28% *
Indirect	39%	42%	72%

* Includes CONUS vending operations - contractor operated but inventory owned by AAFES.

The concession versus direct run methods of operation were reviewed to see which one was "better." The conclusion was that no one method was "better" and it was useful to have a "direct run" or "concession run" option. That flexibility allows maximum patron service, dividends/ contributions to MWR funds, and the ability to quickly react to changing conditions. In fact, services do switch operations to and from direct and concession. Switches are made for many reasons, but the most common were to respond to a new headquarters strategic plan or to respond to an ad hoc, local level problem with either a direct run or a concession operation.

Looking at the whole picture, there were many reasons for favoring one method over the other, but the essence of the rationales for favoring one over the other follow. Since all the services made extensive use of both methods, the rationales apply equally, or proportionately, to all.

Two of the most common reasons for favoring concession operations are that the concessions operate without having the personnel-payroll function part of the exchange. Concession personnel are not exchange employees. Another reason is that concession operations are very often local which has the beneficial effect of getting the local community more knowledgeable about, and directly involved in, the routine of military life. This is good public relations. On the other hand, direct run operations have the benefit of having total control over all aspects of the operation from the service being performed to the price - profit relationship.

There is no intent to imply that converting back and forth between concession and direct run is done easily or often. A service performed by either method tends to be retained in that mode, and converting from concession to direct is likely to invite adverse community and Congressional interest, while converting from direct to concession often means breaking

up an existing infrastructure of careers and methodologies. Nevertheless, retaining the flexibility is valuable and conversion is done. The pitfalls are recognized and efforts are expended to do it right the first time and preclude any adverse impact on customer service or exchange earnings.

"Concession" sales are for record and control purposes only. They are addressed to give an indication of the scope of operations. Concession sales dollars are recorded separately because the sales dollars are not deposited into exchange accounts. The sales dollars belong to the concessionaire. The primary reason for keeping a record of concession sales is for control purposes because concession income from the concessionaire to the exchange is normally a percentage of sales.

There may be short and long term concessionaires. "Short Term" may be from several days to one year, while "Long Term" may be for a year or more and renewable yearly for several additional years. Short term concessionaires provide additional vibrancy, product choice, and interest to enhance patron service and exchange images. Concessionaires also provide a percentage of their sales to the exchange. Sales controls, suitability of items offered, and compliance with the applicable regulations, such as the Armed Service Exchange Regulations, remain with the exchange, which has both the mandate and the infrastructure to do this. Other organizations, such as special interest clubs and private associations, occasionally impinge on this exchange mandate.

An effort was made during this review to measure customer service and prices charged for identical or common services. The basic policy in all three exchange services is that services prices to patrons should provide an overall twenty percent average savings to the patron based on surveys of local prices for the same service. This means that prices and profits vary both within and between the services. For example, in a recent "market basket" survey of services, prices for a regulation haircut was checked at nine Navy exchanges throughout the CONUS. The average price for a haircut was \$3.83, with the median price being \$4.00. The high was \$4.75, in a California "gold coast" location, while the low of \$3.25 was on a base located in mid-America. A copy of this market basket survey of services operations is attached at the end of this chapter. For comparison purposes and to illustrate again the regional nature of services pricing a copy of AAFES vending cold drink prices and regular (regulation) haircut prices throughout CONUS is attached to the end of this chapter.

Finally, an attempt was made to evaluate base and store level operations and staffing. Consolidation of exchange services operations would have minimal impact primarily because staffing has been, and would remain, a function of customer requirements and headquarters determinations

regarding management staffing - where, how many, and grade level. Consolidation in and of itself, would not change the number of barbers, beauticians, vending route persons, tailors, opticians, and so on.

An evaluation of the interactions between the exchange services was undertaken. The relationships were friendly, positive and knowledgeable. They were also competitive. The competitive attitude had the benefit of focusing attention on being efficient.

The Study Group reviewed a specific initiative in progress in the Navy. The Navy had begun a program to gradually convert all its vending operations to direct run. Seven bases had been converted over the last 3 to 27 month period. Annualized projections indicate a \$1.8M or 35% increase in sales and \$1.0M or 83.9% increase in profits over operations that had previously been run by contractors. The initiative was so new and promising that no final conclusion could be made. However, if these initial beneficial results continue, they should be passed on to the AAFES and Marines for their consideration, and they should be continued if the exchange services consolidate.

In summation, with regard to Services Operations, the fact that all the exchange services have a primary concern for patron service and strong policies to achieve it indicate that there are neither major impediments to overcome nor significant efficiency or economy of scale savings to be achieved by consolidating or reconfiguring the existing exchange organizations.

SERVICES OPERATIONS INITIATIVES

The three exchange systems actively try to keep services operations fresh, responsive to patrons, innovative, and profitable. The following are some initiatives being considered.

NAVY:

NAVRESSO envisions embarking on a plan to develop a more all-encompassing image of all aspects of its exchanges and strengthening services managers by developing managers who are trained and specialized in certain individual disciplines. Concurrently, Navy exchanges also plan to move in the direction of increasing their direct run services operations. Specific services segments identified as being targeted for attention are car care malls, photography (developing) shops, optical services and direct run vending.

AAFES:

There are plans to expand the optometry program, after

continuing an ongoing dialogue with the American Optometric Association (AOA), which has expressed concerns about health care. In a different area, AAFES conducted a test for the 1989 tax year to provide concession income tax preparation service. The test was considered a success and there are plans to expand it for next year. Also, AAFES has approved the expansion of a successful name brand car care concept which was tested at two locations and met with significant patron acceptance.

MARINE CORPS:

The whole Marine Corps concept and initiative of combining all MWR and exchange services is in itself innovative and unique.

Optical service is an area having potential for a mutually beneficial joint venture. With combined sales of $38.6M, the potential for combining efforts to open optical labs should be investigated. A lab on each coast can be envisioned, with the West coast also serving Alaska, Hawaii and the Western Pacific and the East coast unit also serving Puerto Rico and Europe.

All services are continually developing new businesses to enhance customers service. Some of these are anticipated to need Congressional approval while others are considered to be within existing approval levels. Some of these new businesses which may have future potential are as follows:

Need Approval/Coordination

- Expansion of optometry
- Dental service
- Routine physical exams
- Investment service
- Real estate home service
- Legal service
- Pharmacies
- Job placement/resume service
- Sale of lottery tickets

Approval within Current Authority:

- Expanded phone services. This may include phone systems in temporary living accommodations, home phone initiatives and expanded overseas operations to include adding additional sites to the AAFES Europe contract as well as contracting for the Pacific.

- Expanded communications center concept to include phone centers, mail centers, fax service, voice messaging, etc.

- Gift buying through catalog service and computer service.

RECOMMENDATIONS

- That the exchange systems continue with the existing mutual cooperation to develop efficiencies, increase service and exchange ideas.

- That, under consolidation, net potential savings of $301,936 be sought in services

operations management costs.

- That projects having potential for mutual benefit, such as opening optical labs, be pursued jointly.

- That a regular review of direct/indirect run services operations be conducted to identify new business opportunities.

CHAPTER 10

FACILITIES/CONSTRUCTION

OVERVIEW

This chapter provides background on the engineering, facilities and construction responsibilities performed by the Army and Air Force Exchange Service (AAFES), Navy Resale and Services Support Office (NAVRESSO) and the Marine Corps Morale, Welfare and Recreation Support Activity(MCMWRSPTACT).

It also addresses similarities and differences in the three exchange services, the current status of the physical plant, size of capital and construction programs and provides conclusions and recommendations at he end of the chapter.

ARMY AND AIR FORCE EXCHANGE SERVICE (AAFES)

ENGINEERING DIRECTORATE

AAFES Engineering Directorate, 102 positions, is responsible for management of the AAFES physical plant, to include programming, planning, design, decor, selection of materials, maintenance, disposal, renovation, replacement, expansion, design and construction of AAFES facilities and equipment.

Engineering Management Division maintains administrative control of the AAFES Capital Program and forecasts requirements; controls AAFES-funded facility leases; administers the Facilities Improvement Group; develops/maintains computer files for facility inventory and project management schedules; plans/designs system applications for the directorate; develops computer programs to support system applications; and prepares correspondence, reports and major project requests for submission to the BOD, DOD and HASC.

Design Development Division develops programs and plans for renovation, replacement, expansion and construction of AAFES physical assets; provides support to operating elements in planning facility projects; prepares supporting technical documents for DOD and HASC submissions; reviews drawings and specifications prepared by architectural/ engineering firms; prepares drawings and specifications for in-house projects; prepares technical input and assists AAFES contracting officers; monitors construction, makes inspection and give final acceptance; prepares major projects for consideration by the Board of Directors.

Construction Division manages the design and construction of new and major expansion projects worldwide; provides technical input and assistance for negotiation of construction contracts; provides scope of services and monitors accomplishment of construction documents by contract architectural/ engineering firms; incorporates energy conservation measures on major projects; monitors construction progress; resolves problems and makes final inspection and acceptance; controls funding allocated for new construction and major expansion projects worldwide; and continues technical support during first operating year of new facilities.

Standards and Criteria Division selects criteria; develops standards, prepares technical specifications and writes procedures for the procurement, administration and control of fixed assets and equipment; develops space criteria and standard definitive layouts for exchange facilities; develops design standards for use in the construction and renovation of exchange facilities; monitors cost trends in the construc- tion industry and publishes guidance for use in estimating the cost to construct and renovate exchange facilities; develops procedures for the repair and maintenance of facilities and equipment; monitors repair and maintenance costs; prepares and distributes repair

and maintenance analysis reports; develops specifications for procurement of electronic point-of-sale systems and cash registers; and develops and monitors the AAFES energy conservation/management program.

The Operations Support Engineering Division, 12 positions, has replaced the five Exchange Region Engineering Branches, a reduction of 24 positions. This office is responsible for design and accomplishment of projects of less than $300,000 - primarily small facelift or renovation projects directly supporting the five CONUS Operations offices. In addition, this office provides equipment and facilities technical assistance to area exchange Facilities Offices.

OPERATIONS

AAFES has just completed a realignment of the organization that has resulted in elimination of one layer of engineering management (Exchange Regions). In CONUS, the Exchange Regions no longer exist. Instead, there are five Operations (includes a Distribution Operation), geographically oriented which act more like a technical assistance office than a command echelon, with offices physically located in Dallas. Each Operation has one UA Engineer (no staff) who functions as an advisor to the Chief of Operations.

AREA EXCHANGE FACILITIES OFFICES

The lowest level of engineering management in AAFES is at the area exchange. Each of the 22 area exchanges in CONUS have a UA-11 or UA-12 (grade of position depends upon size) Facilities Manager who manages a staff of technicians (normally between five and twenty-five carpenters, electricians, refrigeration and air conditioning mechanics, etc.) devoted primarily to repair and maintenance of facilities and equipment (some maintenance staffs devote considerable effort to small projects). This staff may be consolidated at one installation or dispersed to the supported exchanges (usually between five and eight installations), whichever is more economical or feasible based on size, geographical dispersion, span of control and other factors.

Overseas, area exchanges are generally larger and have larger staffs of technicians. In some locations, Facilities Managers are one grade higher than in CONUS where an architectural staff (in addition to a repair and maintenance staff) is also supervised. In Europe, Local Nationals (LN) manage the programs in Greece, Turkey and Spain where the operation is smaller and limited in scope.

AAFES-PACIFIC ENGINEERING DIVISION

AAFES Pacific Engineering Division, 17 positions, is responsible for the acquisition, maintenance and repair, improvement and construction of facilities and equipment in the Pacific (Area Exchanges located in Hawaii, Korea, Okinawa, and the Philippines and offices in Japan and Guam).

Architecture and Engineering Branch develops designs for major facility renovations and provides technical expertise on new construction and major renovation projects; reviews construction design documents prepared by architectural/ engineering firms;

prepares drawings and specifications for in-house projects; selects design consultants, monitors contractor performance and provides periodic on-site project surveillance; and provides architectural/engineering assistance to area exchanges.

Engineering Programs Branch compiles, coordinates and maintains administrative control over the Capital Program; provides guidance on acquiring equipment and obtaining funds for facility repair and renovation; and administers the leasing of facilities.

Equipment and Facilities Branch administers the repair and maintenance program for equipment and facilities; administers the energy conservation program; provides administration and control of fixed assets and equipment; administers the AAFES building schedule program; provides specifications and guidance on acquiring equipment and fixtures; and provides administrative/technical assistance to area exchanges.

AAFES-EUROPE ENGINEERING DIVISION

AAFES-Europe Engineering Division, 85 positions, is responsible for acquisition, maintenance, repair, disposal, improvement, expansion and construction of facilities and equipment in the European Theater (Area Exchanges located in Germany (3), Greece, Italy, Spain, Turkey, and the United Kingdom. It is currently being reduced in size due to the expected troop drawdown in Europe.

Resource Management Branch compiles and maintains administrative control of the long range Capital Program; monitors the exchange facility inventory, coordinates the leasing of facilities, and maintains a computer data base.

Design Branch develops programs and plans for renovation, replacement, new construction and expansion; provides support to operating elements in planning facility improvement projects; reviews drawings and specificaions prepared by architectural-engineering firms/EUD and other construction agencies; manages the construction program; and provides consulting services on engineering matters to area exchanges.

Operations Branch implements procedures for the administration and control of fixed assets and equipment; assists operating elements in replacing equipment and obtaining spare parts; provides technical assistance for the repair and maintenance of facilities and equipment; develops and monitors the energy conservation program; provides guidance and monitors repair of customer's major household appliances; provides repair and maintenance service for theater equipment; and manages stand-alone equipment programs and materials warehouses.

NAVY RESALE AND SERVICES SUPPORT OFFICE (NAVRESSO)

HEADQUARTERS

NAVRESSO Facilities Division, 29 positions, provides general facilities support to Navy Exchanges, ships stores afloat, commissaries, and lodges including:

a. Budgeting
b. Master Planning
c. Siting assistance
d. Layout preparation
e. Interfacing with Naval Facilities Engineering Command (NAVFACENGCOM procures design and construction services for NAVRESSO.)
f. Managing equipment requirements
g. Administering maintenance programs
h. Providing turkey job assistance for new and renovated facilities

Facilities Planning Branch is responsible for long term planning, master plan review, basic facilities requirements, cash flow analysis, PIP program, construction budget, Congressional reporting, minor project program, data base management, and NAVFAC bill processing.

Store Planning Branch is responsible for floor plans, interior design, NAVFAC design review, space allocation, fixture selection, equipment selection, ship store design, prototype management and CAD development.

Architectural/Engineering Branch is responsible for project scope, design authorization, and participates in the architectural/engineering design firm selection, NAVFAC design review, construction contract review, project management, change order approval, project cost control and energy management.

Equipment/Maintenance Branch is responsible for equipment budget management, data base management, equipment specifications, equipment replacement, project related equipment, fixed asset program and facility maintenance.

FIELD SUPPORT OFFICES (FSO)

The next lower echelon of management, NAVRESSO Field Support Offices, has one UA-12 Facilities Maintenance Officer (FMO) who primarily provides staff assistance to the Commanding Officer of the FSO and also provides technical equipment and facilities guidance and support to exchanges within the FSO. The FMO typically has a small clerical staff but no technicians. There are currently seven FSOs in CONUS. NAVRESSO has developed plans to reduce the number of FSOs to three.

INDEPENDENT NAVY EXCHANGES

There are independent Navy exchanges within CONUS that report through directly to NAVRESSO headquarters without going through an FSO. Some of these independents have UA Facilities Maintenance Managers (see Navy Exchange below) with clerical and technical staffs.

NAVY EXCHANGE

The lowest level of engineering management in NAVRESSO is located at the Navy Exchange (installation) where there are UA-8 through 11 Facilities Maintenance Managers (FMM). The FMM has both a clerical and technical staff (carpenters, electricians, refrigeration and air conditioning mechanics, etc.). The primary mission of the FMM is repair and maintenance of facilities and equipment. There are about 32 UA FMM positions worldwide.

MARINE CORPS MWR SUPPORT ACTIVITY (MWRSPTACT)

HEADQUARTERS

The Marine Corps MWR Support Activity engineering effort is limited. There is one professional Architect wth a staff of five personnel at the headquarters. The effort is primarily one of budgeting and coordinating projects with the HQ Marine Corps (HQMC), Field Commands and NAVFACENGCOM, the design and construction agency. Construction is determined based on need and available dollars.

MARINE CORPS EXCHANGE (MCX)

The lowest level of engineering management is located at Marine Corps installations. The UA Facilities Maintenance Managers have a clerical and technical staff to repair and maintain the facilities and equipment. Support at installation level is supplied from Public Works on an as-needed basis. Replacement of equipment that is determined to be a capital asset is submitted by the exchange to MCX headquarters for review and approval.

CURRENT STATUS

ARMY AND AIR FORCE EXCHANGE SERVICE.

Due to a construction update program over the past 20 years, the major AAFES facilities such as main stores/malls/ shopping centers, service station and shoppettes in CONUS are in comparatively good condition. Nearly all have been constructed within the past 20 years and the older ones expanded or renovated within the past 10 years (See Figure 10-1, Comparison of Age of Facilities). All Burger Kings are less than five years old, and a program of constructing convenience stores and activating in-house food outlets is showing great progress.

There are still major shortcomings in the large number of small facilities where 70% are more than 20 years old and 28% are inadequate or substandard (See figures 10-2 and 10-3, Number, Size and Condition of Facilities, Worldwide and in CONUS). Few of these older buildings were designed or constructed with

exchange resale in mind.

Other major shortcomings include the need for a major distribution center on the west coast and an AAFES worldwide backlog of $380 million in facility work. AAFES has made inroads on reducing the rate of increase in the worldwide backlog (not in reducing the backlog). (This backlog should be reevaluated when the troop drawdown becomes clearer, particularly in Europe, and resolution of this study is made.) (See also Figure 10-4, Comparison of Book Value of Assets as of January 1990.)

NAVY RESALE AND SERVICES SUPPORT OFFICE

Based on visits to some 600 selling activities on about 25 Navy bases, a higher percentage of Navy Exchange Facilities need to be renovated than AAFES facilities. This judgement (by the Facilities/Construction Committee) is supported by the amount of capital funds expended (See Annual Capital Programs, Figure 10-5, Comparison of Annual Capital Programs). For the last five years, the average NAVRESSO capital program has been $31.441 million per year or about 20% of the AAFES investment (On aproportional, percentage of sales basis, the NAVRESSO Capital Program would be $43.27 million.) In addition, a high percentage of the NAVRESSO capital investment over the last five years has come from cash reserves rather than current years earnings. For example, of the $42.561 million in the NAVRESSO FY 1988 Capital Program, only $.575 came from FY 1988 earnings. The rest, or $41.986 came from cash reserves. The decision to provide most of the current year earnings to the MWR was a departmental, not NAVRESSO or Facilities Division decision. NAVRESSO has the same problem with the large number of small, World War II and prior year facilities where nearly 69% of the buildings are more than 20 years old and 31% are inadequate or substandard. (It should be noted that the AAFES, NAVRESSO AND MWRSPTACT defininitions of adequate, usable, inadequate, substandard and forced use are not identical and are subject to interpretation by the many field elements providing input to the three systems. The data provided should therefore be used only for an order of magnitude comparison.)

NAVRESSO is also faced with procuring a Management Information System that will amount to at least $100 million. (See Chapter 6, Management Information System.)

NAVRESSO has emphasized projects with the greatest payout and return for several years. Consequently, those projects with lower return on investment, to a great degree, remain to be accomplished.

COMPARISON OF AGE OF FACILITIES
(Percentages of Buildings in Each Age Category)

	AAFES	NAVRESSO	MWRSPTACT
LESS THAN 5 YEARS OLD	9.0%	4.6%	8.3%
5 TO 10 YEARS OLD	4.0%	8.0%	8.1%
10 TO 20 YEARS OLD	17.0%	18.8%	22.8%
20 TO 40 YEARS OLD	34.0%	26.2%	26.6%
OVER 40 YEARS OLD	36.0%	42.4%	34.2%
	100.0%	100.0%	100.0%

NUMBER, SIZE AND CONDITION OF FACILITIES
(As recorded on building inventories by each exchange service)

WORLDWIDE

	AAFES	NAVRESSO	MWRSPTACT
NUMBER OF BUILDINGS	4,820	1,283	454
TOTAL AREA (MILLION SF)	45.61	12.83	3.60
% ADEQUATE (USABLE, CLASS A)	72	69	70
% INADEQUATE USABLE, CLASS B)	23	18	18
% SUBSTANDARD (FORCED USE)	5	13	12

FIGURE 10-2

CONUS

	AAFES	NAVRESSO	MWRSPTACT
NUMBER OF BUILDINGS	2,421	748	314
TOTAL AREA (MILLION SF)	28.20	8.53	2.47
% ADEQUATE (USABLE, CLASS A)	76	71	62
% INADEQUATE (USABLE, CLASS B)	19	12	12
% SUBSTANDARD (FORCED USE)	5	17	26

FIGURE 10-3

COMPARISON OF BOOK VALUE OF ASSETS
AS OF JANUARY 1990
($000)

	AAFES	NAVRESSO	MWRSPTACT
BUILDINGS AND IMPROVEMENTS	581,806	126,939	10,634
VEHICLES (SEDANS AND TRUCKS)	10,734	4,557	Unknown
EQUIPMENT AND OTHER FIXED ASSETS	231,178	40,970	15,442
TOTAL ASSETS	823,718	172,466	26,076
WORK IN PROGRESS (WIP)	104,342	10,540	3,659
TOTAL ASSETS INCLUDING WIP	928,060	183,006	29,735

FIGURE 10-4

Other major shortcomings are:

TYPE FACILITY	LOCATION	CAPITAL FUNDS REQUIRED ($ Millions)
Major Stores:	NS Mayport	7.4
	NAS Alameda	11.4
	NAS Oceana	9.1
	NAS Sigonella	6.2
Distribution Centers:	Pearl Harbor	15.8
	Jacksonville	> Scopes being revised
	Norfolk	> due to FSO consolidations.
Laundries:	NTC San Diego	4.0
	NTC Orlando	4.0

The backlog of current NAVRESSO exchange projects (including the projects above) for FY 90-94 is $84.2 million; projects to replace inadequate facilities of $159.9 million; and projects to replace substandard (forced use) facilities of $100.4 million. The backlog is increasing annually, in part due to inadequate capital investment in the physical plant. (Total current backlog = $344.5 million)

MARINE CORPS MWR SUPPORT ACTIVITY

In general, the condition of the MCX system physical plant falls somewhere between the NAVRESSO and AAFES. A higher percentage of the larger Marine Corps bases in CONUS were visited than Navy. There are some exceptional stores within the Marine Corps Exchange System, for example Henderson Hall, El Toro Marine Corps Air Station and Camp Pendleton. However, about half of the major facilities within the Marine Corps Exchange System in CONUS need to be renovated, expanded or replaced. Projects are in predesign development or programming stages in nearly all instances.

APPROPRIATED FUND SUPPORT

All services are provided appropriated fund support in the engineering-related areas of repair and maintenance of facilities; utilities on a non-reimbursable basis overseas; grounds maintenance; common services such as fire, safety and security; and veterinary inspection services. DoD regulations have been generally

interpreted alike by all three exchange services. No differences have been observed in the amount or type of appropriated fund support received. All three exchange services have interpreted the regulations on leaking underground storage tanks alike and at least two have opted to close service stations and wait for appropriated funds to pay for removal and cleanup of contaminated soil rather than pay for it with non-appropriated funds.

MUTUAL COOPERATION

AAFES Engineering Directorate and NAVRESSO Facilities Divison have a long history of cooperation in the exchange of ideas. Personnel from both headquarters have participated in Engineering (Facilities) conferences with the other. One interchange/cooperative effort even took place during the course of this study. Directors, Deputy Directors, Division/Branch Chiefs of both NAVRESSO Facilities and AAFES Engineering jointly visited the new Fort Bragg (AAFES) and the new Norfolk (NAVRESSO) Shopping Centers. Hopefully, this will continue. Due only to oversight, the Marine Corps representatives did not participate.

CAPITAL PROGRAMS

The amount of funds reinvested in facilities improvements varies between the three exchange services. AAFES has been recapitalizing at an average annual rate of $160.8 million for the last five years. Navy Exchange, on the other hand, has recapitalized $31.441 million per year and the Marine Corps Exchange about $6.0 million average over the last five years. (See Figure 10-5, Comparison of Annual Capital Programs and Figure 10-6, Comparison of Competitors 1989 Capital Programs). Based on a percentage of sales basis, the Navy should have been reinvesting $39.301 million each year and the Marine Corps $4.745 million just to stay even with AAFES. This difference would have been much greater if the amount of funds reinvested by the Navy from current year earnings had been used.

Departmental decisions have often been to provide a greater portion of earnings going to the Morale, Welfare and Recreation funds for the Navy and Marine Corps. In recent years, current program capital investment has had to be augmented by cash reserves to meet capital needs. This method of providing capital investment can continue for only a few years before there will be a shortfall of cash and real, unrecoverable problems with the physical plant.

There will probably always be more facility needs than funds available to do the work. While the AAFES investment in the physical plant is not necessarily ideal, it is targeted to reduce the backlog. To bring NAVRESSO and MWRSPTACT programs up to a proportional level (using sales volume as a basis), capital programs should be about $43.27 million for NAVRESSO (about $32.45 million for construction projects) and $13.01 million ($9.76 million for construction projects) for the MCX. The requirement for additional capital funds is a distinct problem and must be addressed.

Immediately increasing the capital funds available will not cure facilities that have suffered from lack of funds in the recent past. It would only bring future NAVRESSO and MWRSPTACT capital investment levels up to proportionate AAFES levels based on sales volume.

COMPARISON OF ANNUAL CAPITAL PROGRAMS

($000'S)

FISCAL YEAR	AAFES	NAVRESSO	MWRSPTACT *
85	150,000	32,578	3,415
86	156,000	19,401	11,746
87	165,000	41,412	8,113
88	173,000	42,561	450 **
9	160,000	21,251	0 **
5-YEAR AVERAGE:	160,800	31,441	4,745

* Funds for replacement equipment were not available for inclusion in the MWRSPTACT Capital Program. For sake of comparison only, an estimate of 25% additional was added to the MWRSPTACT data above.

** Deferred.

FIGURE 10-5

COMPARISON OF COMPETITORS 1989 CAPITAL PROGRAMS

	SALES ($ Billions)	CAPITAL FUNDS ($ Millions)	% CAPITAL FUNDS TO SALES
SEARS	31.6	631.0	1.99
WALMART	25.80	955.0	3.70
TARGET	7.50	414.0	5.52
K-MART	29.50	631.0	2.13
J.C. PENNEY	16.10	477.0	2.96
AAFES	6.78	* 160.8	2.37
NAVRESSO	1.83	* 31.4	1.72
MWRSPTACT	.55	* 4.7	0.85

* Last five-year average Capital Program

FIGURE 10-6

An exact comparison cannot be accomplished without an exhaustive study of the different firms definitions and capitalization policies. Some companies, for example, lease space and do not capitalize the cost. Other firms make capitalization decisions based on tax advantages. This comparison can therefore only be used for an order of magnitude comparison. The three exchange services are very similar in their capitalization policies.

CONSTRUCTION PROGRAMS

Functions performed by the three engineering organizations of the exchange services are similar. Planning, requirements development, budgeting, store planning, equipment and fixture selection, and maintenance and repair functions of all three Exchange Services are alike. The biggest difference between AAFES Engineering and NAVRESSO and MWRSPTACT Facilities Divisions is in the construction of facilities arena.

FEE STRUCTURE

AAFES has an in-house construction division while NAVRESSO and MWRSPTACT reimburse Naval Facilities (NAVFAC) Engineering Command (NAVFACENGCOM) a fee equal to 4.7% of the cost of construction for design and 6.0% for supervision, inspection and overhead (SIOH). By way of comparison, the AAFES cost for design is 3.825% and between 3.1 and 3.5% for construction management. Summary shown below (Corps of Engineers also shown for comparison purposes):

	AAFES	NAVFAC	COE
DESIGN	3.825%	4.7%	5.4%
CONST. MGT (or SIOH)	3.1% - 3.5%	6.0%	4.7%
TOTAL	6.925% - 7.325%	10.7%	10.1%
AVERAGE	7.125%	10.7%	10.1%

The difference, between AAFES and NAVFAC, of 3.575% seems small on a percentage basis but translates into substantial dollars in a total capital program in which the exchange services are trying to get the absolute best value for each construction dollar. Here is an estimate of the savings to be realized:

NAVRESSO & MWRSPTACT CONST. PROGRAMS: $20.529 million (From Figure 10-7)	
LESS 15% FOR EQUIPMENT:	$3.079 million
LESS ABOUT 10.7% FOR FEES:	$1.867 million
AVAILABLE FOR CONSTRUCTION:	$15.583 million
NAVFAC FEES:	1.667 million
AAFES FEES:	1.110 million
ANNUAL SAVINGS:	.557 million

DESIGN AND CONSTRUCTION TIME

The AAFES Engineering Directorate is small, (compared to NAVFACENGCOM and Corps of Engineers) highly specialized and efficient. Facilities are planned, programmed, designed, constructed and operated by one agency. Project approval is dependent upon need (service) and money available. The Construction Division has about 28 people. Here are the design and construction procedures followed:

o Official responsibility starts upon receipt of the project transfer memorandum from the Design Development Division which includes all necessary

installation, command, department and BOD approvals. However, prior to receipt of this memorandum, actions are initiated to identify a project design architect by submission of a request to the Architect/ Engineer (A/E) Pre-Selection and Selection Boards for identification of an A/E firm to accomplish the design/construction documents. A/E selections are based on competency and integrity of the firms and the matching of each firm's qualifications to requirements peculiar to each project. This includes

matching special functions of the project, cost limitations, geographical/climatic conditions, codes and regulations, etc. Standard Forms 254 on over 500 A/E firms are maintained. Selection of an A/E firm normally takes from two to three weeks but since the process takes place prior to transfer of the project documents to the Construction Division, selection of an A/E firm is not on a critical path. The project architect develops a scope of services tailored to each project. This scope of services, together with the recommended A/E firm, is forwarded to the Support Procurement Division requesting a fee proposal for design services. Upon consumation of the A/E contract, design is started with a Pre-Design Conference at the installation attended by the Construction Division Engineering design team and the Contracting Officer.

o The first A/E submittal is provided at the Concept Design Conference (35%). This phase is the most critical since it establishes the architectural character desired, the structural, mechanical and electrical systems, preliminary project cost, alternatives and associated life cycle costs. A Concept Design Conference is held at the military installation with installation and major command representatives <u>always</u> invited to attend.

o The Interim Design Phase is entered into immediately upon completion of the Concept phase. Upon receipt of the interim design from the A/E firm, documents are again reviewed by AAFES, installation and major command. At this time special attention is given to the operational and functional aspects of the project. Retail, food and services layouts are carefully reviewed and coordinated with the appropriate exchange, area exchange, operations personnel and by the appropriate HQ directorates (retail, food, services, distribution, etc.). Technical sufficiency approval is obtained from the installation and major command, legal sufficiency from AAFES General Counsel, and reconfirmation of project viability and final clearance from the Department of the Air Force or Army. A typical shopping center project of about $3.2 million will take about 238 days to award the design contract, complete design and obtain approvals for the final design.

o The AAFES contracting officer then issues the construction solicitation leading to subsequent contract award. It typically takes 44 days to solicit and award a construction contract.

o At this time, a project construction manager (Construction Management Engineer or CME) isassigned to be responsible for all aspects of the construction phase. The A/E firm that designed the project is normally hired to be the field inspection agent. Construction of a typical $3.2 million shopping center takes 360 days. On completion of construction, the facility is transferred to installation real property records

and a one-year warranty period begins.

By contrast, it takes NAVFAC an average of 90 days to select an A/E firm, 540 days to obtain complete design documents/coordination, 90 days to solicit and 420 days to construct a shopping center. Here's a tabular summary of the times involved:

	AAFES	NAVFAC
DAYS TO SELECT A/E FIRM	14	90
DAYS TO AWARD & DESIGN	238	540
DAYS TO SOLICIT	44	90
DAYS TO CONSTRUCT	360	420
TOTAL DAYS	656	1,140
TOTAL MONTHS (rounded)	22	38

It takes NAVFAC about 16 months longer than AAFES to select a design firm, and renovate, alter, expand or construct a facility. (No effort has been made to determine or compare the time taken by the three exchange services to plan, develop requirements, program funds, and obtain approvals. Each project is unique in this regard and averages would mean very little. The <u>execution</u> of the project after approvals and funding have been obtained is what is being addressed.)

Although it is theoretically possible to speed up the NAVRESSO and MWRSPTACT construction programs by 16 months, under the present conditions, this is not realistic. First of all, NAVFAC has nearly three years worth of projects already designed for which NAVRESSO does not have the capital dollars to fund construction. Secondly, NAVRESSO Facilities Division plans projects far enough in advance so that selection of an A/E firm, procurement of design and design times do not cause a delay in the project. The only real savings that can be realized is in the construction phase. AAFES is routinely four months faster at accomplishing the construction phase than NAVFAC.

SAVINGS ESTIMATES

ESTIMATE OF SAVINGS - SEPARATE EXCHANGE SYSTEMS

Opening facilities faster provides bottom line earnings (new income) earlier. Converting time to money using a calculation of return on capital investment of 7% (see Figure 10-7, Comparison of Annual Construction (Projects) Programs and Attachment 10-1, (Basis for Computing Return on Capital Investment) translates to $.364 million in annual additional earnings if AAFES were to be the designated agent for design and construction for NAVRESSO and MWRSPTACT projects provided there is no increase in capital investment.

Off-setting this annual increase in earnings would be an annual cost of $.450 million for five UAs, one clerical employee and additional coordination costs (See Attachment 10-2, Basis for Computing Personnel Cost Savings.)

Shown below is a summary of the savings in fees, construction times and off-setting personnel costs for a combined NAVRESSO and MWRSPTACT construction program accomplished by AAFES with no increase in the average capital program for construction over the last five years:

COMBINED NAVRESSO/MWRSPTACT	
CONSTRUCTION PROGRAM	$15.583 million
SAVINGS IN FEES	$.557 million
SAVINGS IN CONSTRUCTION TIME	$.364 million
TOTAL SAVINGS	$.921 million
ADDITIONAL PERSONNEL COST	$.450 million
ACTUAL SAVINGS	$.471 million

If the level of capital program NAVRESSO and MWRSPTACT were to be increased by 25%, and 75% of the funds used in construction, the savings would be $.920 million in fees and $.601 million in savings (earnings) by decreasing the time spent in construcion, providing earnings four months earlier. This would

be offset by $.600 million for 7 UAs, 1 clerical employee and additional coordination costs. Real savings would be $.921 million annually.

If NAVRESSO and MWRSPTACT increased the level of capital investment to that of AAFES (a percentage increase based on sales), and 75% of the funds used in construction, the savings would be $1.145 in fees and $.748 million in savings (earnings) by decreasing the time spent in construction by four months, thereby increasing earnings earlier. This would be offset by by personnel and coordination costs of $.660 million or a real annual savings of $1.233 million. To summarize:

INCREASE CONSTRUCTION PROGRAM ($ Millions)	BY 25%	TO AAFES LEVELS
ADJUSTED CONSTRUCTION PROGRAM	$33.923	$42.212
LESS 15% FOR EQUIPMENT	5.088	6.332
LESS ABOUT 10.7% FOR FEES	3.085	3.839
AVAILABLE FOR CONSTRUCTION	25.750	32.041
NAVFAC FEES	2.755	3.428
AAFES FEES	1.835	2.283
SAVINGS IN FEES	.920	1.145
SAVINGS IN CONSTRUCTION TIME	.601	.748
TOTAL SAVINGS	1.521	1.893
ADDITIONAL PERSONNEL COSTS	.600	.660
ACTUAL SAVINGS	.921	1.233

ESTIMATE OF SAVINGS - TOTAL CONSOLIDATION

Under a fully merged Engineering organization, additional savings of $2.0 million could be realized due to personnel reductions, $1.0 each

for the headquarters and for the field. This would be offset somewhat by one-time personnel relocation costs. (See Figure 10-7, Estimate of Savings - Facilities/Construction.) A summary under full consolidation:

SUMMARY OF SAVINGS UNDER TOTAL CONSOLIDATION

	SAVINGS IN $ MILLIONS			
	FEES	CONSTR TIME	PERSONNEL	TOTAL
LOW ESTIMATE	.557	.364	2.000	2.921
BEST ESTIMATE	.920	.601	2.000	3.521
HIGH ESTIMATE	1.145	.748	2.000	3.893

DESIGN AND CONSTRUCTION BY NAVFAC AND COE

NAVFAC and COE can provide design and construction management services, but on a more costly basis than AAFES. AAFES fees are 3.575% lower than NAVFAC and 2.975% lower than COE. Procurement, design and construction times are at least 16 months faster on an individual project basis by AAFES. In addition, the Corps and NAVFAC cannot be as responsive to business needs of a client as an in-house engineering department; cannot make changes to construction contracts in as timely a manner; and neither the Corps or NAVFAC have professional architects, engineers and store planners dedicated to retail, food and services needs.

CREDIBILTY OF THE ANALYSIS

Refer to Attachment 10-3 for direct quotes from The Jones Commission Study of the Military Commissary System.

FIGURE 10-7

COMPARISON OF ANNUAL CONSTRUCTION (PROJECTS) PROGRAMS

($000's)

FISCAL YEAR	AAFES	NAVRESSO	MWRSPTACT
85	112,250	16,478	2,732
86	117,000	6,683	9,379
87	123,750	24,012	6,490
88	129,750	24,561	360 *
89	120,000	11,951	0 *
5-YEAR AVERAGE:	120,550	16,737	3,792

* Deferred.

CONCLUSIONS

1. All three engineering departments are performing in an Exceptional manner under DoD guidelines. Policies are nearly identical. Functions and procedures differ somewhat.

2. Engineering departments of AAFES and NAVRESSO have a long history of cooperation.

3. AAFES Engineering and NAVRESSO Facilities have recently reduced personnel and both are in the process of further reductions.

4. Navy is taking a larger portion of the earnings for MWR support. On a percentage of sales basis, they retain less earnings for capital improvements. This is reflected in the condition of facilities.

5. AAFES, with the only design and construction department can construct and open facilities faster than the other two exchange services. This results in earlier earnings from earlier openings.

6. If AAFES is designated the design and construction agent for NAVRESSO and the Marine Corps Exchange (without consoldiating) and without additional capital funds, the actual savings are estimated at $.471 million. Under total consolidation, the savings would be about $2.921 million. The best estimate of savings under total consolidation (an increase of 25% in the capital program and using 75% of these funds in construction) is $3.521 million.

RECOMMENDAIONS

1. Assign AAFES as the design and construction agent for design and construction facility regardless of the decision on consolidation.

ATTACHMENT 10-1
FACILITIES/CONSTRUCTION
BASIS FOR COMPUTING RETURN ON CAPITAL INVESTMENT

1. Under any option considered, if AAFES is to become the design and construction agent for NEX and MCX, then the increase in direct operation results (DOR) before depreciation should be the same. The only difference is that in full consolidation, there is a personnel cost reduction savings, and a cost to relocate personnel.

2. Looked at all projects obtainable in AAFES in which the post evaluation was completed (projects had at least one full year of operation results). The capital investment for these 30 projects was $65.208 million and the earnings before depreciation in 1989 was $15,536,316.

This increase in earnings ($6,638,580) is an increase in earnings on capital investment of 10.18% (see following pages 3 & 4).

3. Looked at same projects as in 2 above except took out Burger King projects since NAVRESSO and the Marine Corps have essentially completed their McDonalds programs. In addition, took out those projects which reflected a $0 (zero) in the column labeled AVG MONTHLY EARNINGS BEFORE PROJECT since this distorted the final data.

This resulted in an increase in return on capital investment of 8.28% (see following pages 5 & 6).

4. Looked at projects in which the post evaluation was completed and which had at least two full years of operation results. The capital investment for these 47 projects was $109.039 million and earnings before depreciation in 1989 was $39,481,320. This increase in earnings of $13,117,848 is an increase in return on capital investment of 12.15%. (See following pages 7 & 8).

5. Followed the same procedures as in paragraph 3 above and calculated an increase in return on investment of 7.85%.
(See following pages 9 & 10.)

6. The average return on capital investment for the two lists of projects (projects completed one year ago and those completed two years ago, deleting Burger Kings and $0 earnings before project initiatiated) is 8.0%.

7. Assuming that NEX and MCX have accomplished many of those projects

with the highest return on investment and left most of those with low return (such as distribution centers, laundries and exchanges that must be replaced because of structural damage [Alameda NAS]), the return on capital investment will be lower. Use 7% return on capital investment as an estimate.

BASIS FOR COMPUTING RETURN ON CAPITAL INVESTMENT
(PROJECTS COMPLETED, ONE YEAR SALES EVALUATED)

	CAPITAL INVESTMENT ($ Million)	AVG MONTHLY EARNINGS BEFORE DEPRECIATION ($)	AVG MONTHLY EARNINGS BEFORE PROJECT ($)
FORT DRUM S/C	9.024	73,051	0
FORT IRWIN S/C	4.298	41,635	41,776
FAIRCHILD AFB S/C	5.605	60,594	67,458
COMISO A/S	3.091	(10,764)	26
CHANUTE AFB B/E	.929	14,269	10,314
FORT SHERIDAN S/C	3.709	(34,892)	925
FORT KNOX B/E	1.175	32,440	20,260
FORT KNOX MINI-MALL	1.743	59,743	25,447
FORT HOOD B/E	1.511	81,111	23,449
FAIRCHILD AFB B/E	1.012	17,233	5,675
MATHER AFB B/E	1.144	19,883	6,977
PRESIDIO OF SF B/E	1.085	11,952	(2,874)
AVIANO CONC MALL	.899	22,392	6,955
MANNHEIM AUD/PHO	2.106	97,808	57,505
GEORGE AFB BK	.848	27,713	7,991
SCOTT AFB BK	.952	33,072	15,509
FORT DEVINS AFB BK	.893	29,297	0
MCCHORD AFB BK	.871	24,844	9,987
CHARLESTON AFB BK	.962	21,106	0
MT HOME AFB BK	.738	7,293	4,646

BERGSTROM AFB BK	.805	7,631	3,178
LACKLAND AFB BK	.961	21,436	1,176
NORTON AFB BK	.962	46,328	19,996
BEALE AFB BK	.820	14,185	(297)
EIELSON AFB BK	1.084	11,329	5,542
PETERSON AFB S/C	2.736	70,221	53,558
HILL AFB S/S	3.554	83,419	74,503
MAXWELL SVC STA	1.091	38,834	9,271
BENTWATERS AB S/C	5.750	117,854	121,475
VOGELWEH CAFETERIA	.741	63,245	20,120
CAMP ZAMA S/C	1.247	92,925	82,663
CAMP COURTNEY S/S	.535	54,182	21,748
BAD HERSFELD S/C	1.435	8,330	13,742
EGLIN AFB BK	.892	34,994	12,777
	$65.208	$1,294,693	$741,478

(30 projects)

TOTAL CAPITAL INVESTMENT:	$65,208,000
EARNINGS BEFORE DEPRECIATION, 1989:	$15,536,316
EARNINGS BEFORE PROJECT: (Also before depreciation)	$ 8,897,736
INCREASE IN EARNINGS:	$ 6,638,580
RETURN ON INVESTMENT:	10.18%

BASIS FOR COMPUTING RETURN ON CAPITAL INVESTMENT
(PROJECTS COMPLETED, ONE YEAR SALES EVALUATED)

	CAPITAL INVESTMENT ($ Million)	AVG MONTHLY EARNINGS BEFORE DEPRECIATION ($)	AVG MONTHLY EARNINGS BEFORE PROJECT ($)
FORT IRWIN S/C	4.298	41,635	41,776
FAIRCHILD AFB S/C	5.605	60,594	67,458
CHANUTE AFB B/E	.929	14,269	10,314
FORT SHERIDAN S/C	3.709	(34,892)	925
FORT KNOX B/E	1.175	32,440	20,260
FORT KNOX MINI-MALL	1.743	59,743	25,447
FORT HOOD B/E	1.511	81,111	23,449
FAIRCHILD AFB B/E	1.012	17,233	5,675
MATHER AFB B/E	1.144	19,883	6,977
PRESIDIO OF SF B/E	1.085	11,952	(2,874)
AVIANO CONC MALL	.899	22,392	6,955
MANNHEIM AUD/PHO	2.106	97,808	57,505
PETERSON AFB S/C	2.736	70,221	53,558
HILL AFB S/S	3.554	83,419	74,503
MAXWELL SVC STA	1.091	38,834	9,271
BENTWATERS AB S/C	5.750	117,854	121,475
VOGELWEH CAFETERIA	.741	63,245	20,120
CAMP ZAMA S/C	1.247	92,925	82,663
CAMP COURTNEY S/S	.535	54,182	21,748
BAD HERSFELD S/C	1.435	8,330	13,742
	$42,305	$953,178	$660,947
(20 projects)			

This list of projects differs from the prior list in two ways. First of all, the Burger King projects have been deleted since NAVRESSO and the Marine Corps have essentially completed the fast food franchise program.

Secondly, those projects for which little or no AVG MONTHLY EARNINGS BEFORE PROJECT (far right column) were reflected, were deleted, since if there was no activity before the project, it would distort the data by including them.

TOTAL CAPITAL INVESTMENT: $42,305,000

EARNINGS BEFORE DEPRECIATION, 1989:	$11,438,136
EARNINGS BEFORE PROJECT: (Also before depreciation)	$ 7,931,364
INCREASE IN EARNINGS:	$ 3,506,772
RETURN ON INVESTMENT:	8.28%

BASIS FOR COMPUTING RETURN ON CAPITAL INVESTMENT
(PROJECTS COMPLETED, TWO YEAR SALES EVALUATED)

	CAPITAL INVESTMENT ($ Million)	AVG MONTHLY EARNINGS BEFORE DEPRECIATION ($)	AVG MONTHLY EARNINGS BEFORE PROJECT ($)
ALCONBURY BK	1.373	41,635	10,165
FUERTH BK	1.669	78,781	29,509
WUERZBURG BK	1.772	(794)	12,563
PATRICK AFB BK	.760	21,419	1,928
FORT EUSTIS BK	1.014	38,882	15,392
FORT SAM HOUSTON BK	1.372	35,698	0
FORT LEAVENWORTH BK	.990	21,019	8,836
ELLSWORTH AFB BK	.973	8,958	0
MACDILL AFB BK	.920	17,017	3,491
TYNDALL AFB BK	.880	16,634	2,315
MARCH AFB BK	1.100	41,108	18,185
DAVIS MONTHAN AFB BK	.955	24,896	0
MINOT AFB BK	.740	18,553	0
FORT IRWIN BK	1.094	52,737	14,517
FORT DIX BK	1.720	50,430	16,790
FT DIX CAR CARE CEN	3.096	57,692	22,993
YONGSAN AUTO GARAGE	2.127	7,108	10,881
COMISO AB CAFETERIA	.839	1,319	0
CAMP FOSTER B/E	1.337	43,714	16,548
FORT JACKSON B/E	1.158	27,234	31,149
FORT IRWIN B/E	1.137	33,477	29,143
FORT LEO WOOD B/E	1.050	11,924	9,043
CAMP CASEY S/C	5.008	209,363	113,539
HEILBRONN S/C	8.632	39,361	59,973
YOKOTA AB BK	1.834	89,545	32,947
FAIRCHILD AFB BK	.839	16,783	3,204
HOMESTEAD AFB BK	.840	26,106	6,411
FORT HUACHUCA S/C	4.085	53,900	86,131
RAF BENTWATERS BK	1.386	28,269	0
PRES/MONTEREY S/C	4.302	35,775	13,331

OSAN AB BK	.733	76,493	64,529
BAD KREUZNACH BK	.994	15,091	6,310
BABENHAUSEN BK	1.147	20,473	8,353
FULDA M/E	1.165	54,130	50,260
FORT SILL PIZZA	.558	10,507	8,667
GREENHAM COMMON FF	.745	5,907	679
BABENHAUSEN M/E	.695	36,199	20,987
FURETH S/C	9.897	440,900	370,504
MACDILL AFB M/E MPA	.718	188,192	200,323
FORT BELVOIR M/E	4.009	206,944	172,911
CARSWELL AFB M/E	2.702	212,841	160,409
RANDOLPH AFB S/C	9.944	149,764	108,679
MCCHORD AFB S/C	9.029	314,598	166,145
FORT STEWART S/C	3.366	96,661	65,800
LANGLEY AFB S/C	3.475	134,142	127,032
BLYTHEVILLE AFB S/C	2.546	20,181	16,360
KADENA AB BK	2.314	158,544	69,024
	\$109,039	\$3,290,110	\$2,185,956

(47 Projects)

TOTAL CAPITAL INVESTMENT: \$109,039,000

EARNINGS BEFORE DEPRECIATION: \$ 39,481,320

EARNINGS BEFORE PROJECT: \$ 26,231,472
(Also before depreciation)

INCREASE IN EARNINGS: \$ 13,249,848

RETURN ON INVESTMENT: 12.15%

BASIS FOR COMPUTING RETURN ON CAPITAL INVESTMENT
(PROJECTS COMPLETED, TWO YEAR SALES EVALUATED)

	CAPITAL INVESTMENT ($ Million)	AVG MONTHLY EARNINGS BEFORE DEPRECIATION ($)	AVG MONTHLY EARNINGS BEFORE PROJECT ($)
FT DIX CAR CARE CEN	3.096	57,692	22,993
YONGSAN AUTO GARAGE	2.127	7,108	10,881
CAMP FOSTER B/E	1.337	43,714	16,548
FORT JACKSON B/E	1.158	27,234	31,149
FORT IRWIN B/E	1.137	33,477	29,143
FORT LEO WOOD B/E	1.050	11,924	9,043
CAMP CASEY S/C	5.008	209,363	113,539
HEILBRONN S/C	8.632	39,361	59,973
FORT HUACHUCA S/C	4.085	53,900	86,131
PRES/MONTEREY S/C	4.302	35,775	13,331
FULDA M/E	1.165	54,130	50,260
FORT SILL PIZZA	.558	10,507	8,667
GREENHAM COMMON FF	.745	5,907	679
BABENHAUSEN M/E	.695	36,199	20,987
FURETH S/C	9.897	440,900	370,504
MACDILL AFB M/E MPA	.718	188,192	200,323
FORT BELVOIR M/E	4.009	206,944	172,911
CARSWELL AFB M/E	2.702	212,841	160,409
RANDOLPH AFB S/C	9.944	149,764	108,679
MCCHORD AFB S/C	9.029	314,598	166,145
FORT STEWART S/C	3.366	96,661	65,800
LANGLEY AFB S/C	3.475	134,142	127,032
BLYTHEVILLE AFB S/C	2.546	20,181	16,360
	$80.781	$2,390,514	$1,861,487

(23 Projects)

This list of projects differs from the prior list in two ways. The Burger King projects and those activities that had no ($0) earnings before the new project was initiated were deleted to prevent distortion of the data.

CAPITAL INVESTMENT:	$80,781,000
EARNINGS BEFORE DEPRECIATION:	$28,686,168
EARNINGS BEFORE PROJECT: (Also before depreciation)	$22,337,844
INCREASE IN EARNINGS:	$6,348,324
RETURN ON INVESTMENT:	7.85%

ATTACHMENT 10-2

BASIS FOR COMPUTING PERSONNEL COST SAVINGS

BASIC PERSONNEL COSTS

1. Use basic personnel costs plus 37% fringe benefits as shown in the following table:

UA/GM/GS (step 4)	BASIC PAY	BASIC PLUS 37% FRINGE BENEFITS
15	$65,138	$89,203
14	55,376	75,865
13	46,861	66,940
12	39,407	53,988
11	32,879	45,044
10	29,927	41,000
9	27,177	37,232
8	24,605	33,709
7	22,214	30,433
6	19,662	26,937
5	17,937	24,574

SEPARATE EXCHANGE SYSTEMS OR PARTIAL CONSOLIDATION

2. Under these options, identical for engineering purposes, AAFES Engineering would be the design and construction agent for NEX and MCX projects; NEX and MCX Facilities Divisions would remain intact and in place.

A. This LOW ESTIMATED SAVINGS option provides five UA-12 professionals and one clerical employee to AAFES Engineering Directorate to accomplish $16.737 million in NEX projects (renovation, expansion, alteration, and new construction projects) and $3.792 million in MCX projects at the same rate of capital expenditure that has occurred over the last five years. There will also be additional coordination costs between NEX and AAFES, between MCX and AAFES, and between AAFES and the installation Public Works/Civil Engineering. Here's a summary:

5 UA-12 Employees	x	$53,988	=	$269,940
1 Clerical	x	24,574	=	24,574 *
				$294,514
Additional Coord. Est.			=	150,000
Total			=	444,514
			Say	$450,000

* Cost may be overstated.

B. This BEST ESTIMATE SAVINGS augments the AAFES Engineering Directorate by seven UA-12 professionals and one clerical employee to accomplish $29.475 million in NEX projects (renovation, expansion, alteration and new construction) and $4.448 million in MCX projects at a 25% increase in the rate of investment over the average for NEX and MCX for the last five years. Coordination costs are also reflected. (Note that this is an increase in CAPITAL FUNDS of 25% AND uses 75% of capital funds in projects.)

7 UA-12 Employees	x $53,988	=	$377,916
1 Clerical	x 24,574	=	24,574 *
			$402,490
Coordination estimated		=	200,000
Total		=	$602,514
		Say	$600,000

* Cost may be overstated

C. The HIGH SAVINGS option provides for the same staffing as in 2C above but at a rate of capital investment that is the same as AAFES (on a percentage of sales basis). Again, this option provides for the 75% of the capital funds to be used for projects and 25% for replacement equipment. The following table reflects the adjusted programs.

	CAPITAL PROGRAM	CONSTRUCTION (PROJECTS)
NEX	$43.270	$32.452
MCX	$13.010	9.760
TOTAL	$56.280	$42.212

Personnel and coordination costs for this option would not be appreciably higher than the best estimate above, say 10%. Cost would therefore be about $660,000.

TOTAL CONSOLIDATION

3. Total consolidation from an engineering perspective envisions a merging of the three headquarters into one office in Dallas and a consolidation of FSOs and AXs. FMO positions at the FSOs would be eliminated as would the FMM positions at exchange level. Either there would be additional area exchanges or an increase in the number of exchanges managed by each area exchange. In either case, at least half of the field UAs would be retained, a personnel cost reduction of 50%.

A. The following table reflects the current staffing at NAVRESSO Facilities Divison and MCX Engineering.

UA	CURRENT NUMBER OF POSITIONS NEX	MCES	PERSONNEL COST BASIC PLUS 37% FRINGE BENEFITS
14	1	1	151,730
13	5	1 *	401,640
12	9	3	647,865
11	5		225,220
10	5		205,000
9			
8			
7			
6			
5	4	1	122,870
TOTAL	29	6	$1,754,325

* GM, not UA position

B. Shown below is a summary of the personnel costs involved to augment the current AAFES Engineering and Marketing staffs to work under the fully consolidated option:

DIVISION	NO./TYPE	COST
EN-M	1 UA-9 1 Clerical	$37,232 24,574
EN-A	4 UA-12	215,952
EN-S	1 UA-12	53,988
EN-C	3 UA-12	161,964
OPS SPT	3 UA-12	161,964
MK-P	2 UA-12	107,976
TOTAL	15	$763,650

EN-M = Engineering Management Division
EN-M = Design Development Division
EN-S = Standards and Criteria Division
EN-C = Construction Division

OPS SPT = The Operations Support Center is the new office building in Dallas that will undertake the small renovation/facelift projects under $300,000. It replaces Engineering Branches in the four Exchange Regions.

MK-P = Store Planning Division of Marketing Directorate has responsibility for store layout and equipment, merchandise presentation, decor and visual merchandising.

C. The personnel cost savings is the difference between $1,754,325 (current headquarters NAVRESSO and MWRSPTACT personnel costs, see above) and $763,650 (additions to current AAFES Engineering Staff, see above) or $990,675. Say $1.0 million savings in salaries for headquarters engineering personnel (20 positions eliminated).

D. There are about 40 FMO and FMM positions worldwide in NEX and 8 in MCES. Assume that half the positions will be eliminated. The other half will be changed to Facilities Managers or Assistant Facilities Managers for the consolidated organization at AX level. The following table reflects numbers of positions and personnel costs.

UA	CURRENT NUMBER OF POSITIONS NAVRESSO	MWRSPTACT	PERSONNEL COST BASIC PLUS 37% FRINGE BENEFITS
12	10	5	$809,820
11	10		450,440
10	10	3	533,000
9	6		223,392
8	4		134,836
TOTAL	40	8	$2,151,488

E. A 50% reduction in UA facilities management personnel costs in the field equates to a savings of $1,075,744. Say $1.0 million savings in salaries for field engineering personnel (24 positions eliminated).

F. There are also personnel cost savings to be realized in consolidating the AAFES, NAVRESSO and MWRSPTACT technical staffs (carpenters, electricians, refrigeration and air conditioning mechanics, etc.) at exchange and area exchange (FSO) level. However, the savings are directly related to how the consolidation would take place, the geographic dispersion of exchanges and an economic analysis of the best way to operate the repair and maintenance function in each location. That study and evaluation is beyond the scope of this report.

G. Total personnel cost savings in the headquarters and field is therefore conservatively estimated at $2.0 million per year.

ATTACH 10-3

To add credibility to the analysis above, the following information has been extracted from The Jones Commission DOD Study of the Military Commissary System, dated December 18, 1989, Chapter 8. Although this study dealt with the Commissaries, design and construction times by NAVFAC would be on the same order of magnitude for exchange facilities, which are certainly more complicated to design and build.

"Analysis of the Services' commissary construction requirements to avoid duplication can best be done with a consolidated construction program." - PAGE 8-15

"As long as the Corps of Engineers and the NAVFAC continue to be the construction agent for the Army and Navy, the Design/Build procurement procedure is the most viable." - PAGE 8-19

"If allowed to operate as a NAF entity, the FAR could be waived. Like AAFES, more streamlined procurement procedures can be followed." -PAGE 8-22

"The consolidation of the engineering function would save approximately $1 million in salaries." - PAGE 8-24

"The consolidation of the engineering efforts should be done as soon as practical regardless of whether or not any other aspect of the commissary function or services merge." - PAGE 8-26

"Eliminating the dependency on outside agencies whenever possible, i.e., Corps of Engineers, NAVFAC, Air Force Base Engineering and Contracting, will greatly improve the efficiency and effectiveness of an engineering function." - PAGE 8-27

"The combining of the construction funds with a prioritized consolidated construction program will best spend the patrons' funds in correcting the most urgently needed requirements." - PAGE 8-27

CHAPTER 11

HUMAN RESOURCES

OVERVIEW

Management theorists and "hands on" corporate executives have long been in agreement on one major issue: the most important asset to an organization is its people resources. This is especially true in the retail industry, where the margin for success is razor thin, and a company must strive to compete with, yet differentiate itself, from other businesses selling essentially the same products and services. It is vital that a consolidated exchange system have the authority to manage its work-force and develop policies specifically designed to attract, develop, motivate and retain customer service-oriented employees.

How payroll dollars are managed in the future is a critical issue to the success of the military exchanges and offers a significant opportunity for personnel systems' efficiencies and elimination of duplication of effort through a better run personnel program.

Personnel policies, procedures, and regulations for all DoD civilian and off duty military employees whose compensation is derived from NAF funds are regulated only broadly at the DoD level. Although NAFI employees are Federal employees within the DoD, they are removed from the provisions of laws and regulations administered by the U.S. Office of Personnel Management (OPM) for Civil Service employees, except Equal Employment Opportunity (EEO), Federal service labor relations statutes, wage fixing for prevailing rate (Crafts and Trades) employees, and application of the Longshore-men's and Harbor Workers' Compensation Act and the Fair Labor Standards Act.

The Assistant Secretary of Defense (Force Management and Personnel) [ASD (FM&P)] is

responsible for all personnel policy matters related to NAF employees within DoD. The Deputy Assistant Secretary of Defense (Civilian Personnel Policy) [DASD(CPP)] administers these policies through the DoD NAF Civilian Personnel Policy Office.

The authority and responsibility for development and execution of NAFI personnel management programs has been delegated to the Heads of the DoD Components (the Office of the Secretary of Defense, the Military Departments, the Defense Agencies, and the Army and Air Force Exchange Service).

This chapter analyzes the existing incentives, training, career management, recruiting methodologies, use of assigned military personnel, employment programs, compensation, position classification, and labor relations. It provides a discussion of how these functions can be improved.

Having departmental/ defense agency equivalency in the DoD hierarchy appears to give AAFES much more flexibility and less intermediate layering within the DoD organizational structure than Navy Resale or Marine Corps. The regulatory guidance setting forth the civilian personnel policies of the Army and Air Force Exchange Service is contained in a single joint publication, AR 60-21/AFR 147-15, "Exchange Service Personnel Policies". Implementing and operating procedures are prepared by HQs AAFES.

The PEOPLE Resources staff of Headquarters, AAFES is comprised of a Directorate Chief, a professional staff of 78 and support staff of 29 personnel. AAFES-Europe and -Pacific and the Director for CONUS Operations (DCO) have a staff of approximately 32 individuals in the various personnel functions. These figures exclude Local National employees in the personnel functions overseas.

The Department of the Navy (DON) implements the policies and principles set forth by DoD via a SECNAVINST which delegates management of NAFI civilian personnel programs to the Heads of the NAFI Headquarters Elements within DON:

The Commandant of the Marine Corps (CMC) for all NAFIs falling under the cognizance of the Marine Corps.

Commander, Navy Resale and Services Support Office (NAVRESSO) for all Navy Exchanges and other NAFIs falling under the cognizance of NAVRESSO.

The CMC redelegated responsibility for NAF civilian personnel management to the Morale, Welfare and Recreation Support Activity (MWRSPTACT)/[CMC(MWP)]. The personnel function in the MWRSPTACT provides operating personnel services for the MWRSPTACT as well as policy and procedural guidance for the Marine Corps MWR Program and Marine Corps civilian NAFIs worldwide.

The headquarters' staff, located at the MWRSPTACT in Quantico, Virginia, is comprised of a Branch Head, five specialists, and a clerical employee. The Headquarters staff is divided among appropriated fund and nonappropriated fund employees. Resources dedicated to the personnel function provide

servicing for more than retail (exchange) type employees.

The Navy Resale system headquarters (NAVRESSO) is located at the Naval Station New York, Staten Island. The staff is comprised of 46 personnelists and 23 support personnel. Additionally, their Field Support Office (FSO) staff is comprised of 32 personnelists and 72 support personnel.

11.1

INCENTIVE & PERFORMANCE AWARDS

BACKGROUND

Incentive and/or performance award program is to motivate employees to increased productivity by rewarding those who have made significant contributions to the mission of the organization or whose performance is substantially above the normal job requirements. These pro-grams include both cash and non-cash awards for performance, special actions, suggestions, inventions, as well as honorary (non-monetary) awards for a broad range of contributions.

Incentive awards are the most flexible type of awards. They can be given for a single contribution or accomplishment which may or may not be job related.

Performance awards are designed to recognize performance consistent with an employee's official performance rating. Performance awards always involve cash (lump sum or a quality salary increase), and are given once a year.

DISCUSSION

Navy Resale and Marine Corps awards programs include a $7,500 upper limit on a single award for an individual in a year and eligibility for NAFI employees to receive many of the same DON honorary awards available to appropriated fund employees.

NAVY RESALE

Navy Resale provides a flexible and diverse incentive and performance awards program to its employees which includes individual and group monetary and honorary non-monetary awards as well as activity honorary awards. There are letters of appreciation/ commendation, gift certificates, savings bonds, medallions, plaques, trophies, etc. available for many of the awards.

A noteworthy accomplish-ment of the Navy Resale program is implementation of "Gain Sharing" in four areas. This program was developed to increase sales, gross profit, net contribution, employee morale and reduce employee turnover.

The shoe departments selling staff may participate in a Team Incentive Award given only when actual sales exceed planned sales for the month. The amount of the award is 20% of the additional gross profit dollars realized with the amount each employee receives dependent upon the percentage volume of sales he or she generated during the month.

A second type is the

Productivity Gain Sharing for vending route personnel based on the additional gross profit dollars realized. Individual awards are based upon the number of hours worked during the month.

There is also a Productivity Enhancement Award for civilian Contracting Officer's Technical Representatives (COTRs). This award is to encourage those with income-producing long-term concession contracts to generate additional sales and profits. An award is paid for each contract on which actual sales in the incentive period exceed the previous twelve months' sales.

Finally, Navy Resale offers the Special Group Accomplishment Incentive Award (SGAIA) for improved operations and to recognize deserving employees. The SGAIA is presented to non-management employees when the combined retail and services department sales performance over a three-month period is 3% greater than planned dollar sales. The SGAIA is presented to management employees when the net profit dollars received are 5% greater than planned net profit dollars. The awards presented are Navy exchange gift certificates.

Navy Resale has a bonus award program for the Senior Management Program (SMP) employees. It is similar to the appropriated fund's Performance Management Recognition System (PMRS) for GM-13 through 15 employees and is limited to SMP members. It offers merit-based salary increases and one-time cash bonuses tied to the official performance rating. The awards pool ranges from 2-10% of the aggregate SMP members' base pay with individual performance awards of not less than 1% to a maximum of 15% of base pay.

Navy Resale believes the ability to provide these extra incentives increases employee morale and consequently has a positive impact on sales, net contribution and employee turnover as well as a positive impact on customer service. There are naturally administrative burdens and record keeping required to administer a program of this magnitude but the positive aspects outweigh the negative.

MARINE CORPS

The Marine Corps program is delegated to the command level to the head of the local NAFI. A recently issued draft Marine Corps Order, MCO 5300.9C, "Marine Corps Nonappropriated Fund Instrumentality (NAFI) Personnel Manual" provides for the first time uniform detailed guidance to the heads of the local of NAFIs for managing and administering their programs. No budgetary guidance, award amount scale, frequency schedule, approval levels etc. have been promulgated due to the autonomy of command prerogative.

AAFES

AAFES has a broad incentive awards program covering both honorary and monetary awards. AAFES does not differentiate between incentive and performance awards (i.e.., performance rating of record has no direct relationship on receipt or amount of award). Their program has a well documented formal review and approval process in Exchange

Operating Procedure (EOP) 15-7.. The EOP also provides detailed guidance on each type of award and the amount of cash award authorized. Additionally, AAFES has a special award called the "Commander's Customer-Service Award" which recognizes employees who have gone beyond what is customary in serving the AAFES customer. Their program appears to have full employee participation and "top down" management support.

RECOMMENDATIONS

11.1a Consolidation notwithstanding:

o both Marine Corps and AAFES should review and evaluate the gain sharing programs in Navy Resale. If the program shows productivity increases, better morale and enhanced customer satisfaction, AAFES and Marine Corps should implement similar programs.

o AAFES should assess the need for a performance based award which is linked directly to an employees official performance rating.

11.1b If full consolidation occurs an incentive and performance awards program should be developed using the best features of the existing exchange systems' programs.

11.2 TRAINING

BACKGROUND

The AAFES Training program aims to help place AAFES at a strategic advantage in the marketplace. With corporate training elements at HQ AAFES, AAFES Europe, and AAFES Pacific, integrated channels exist for training guidance to reach every operating level.

Prior to establishing the Navy Resale Career Academy (NRCA), civilian training had traditionally been given low priority. The training materials were outdated and there was no training structure in place. There was concern within the Navy Resale that managers and supervisors had lost their training skills.

The MWRSPTACT has allowed decentralized training program to continue for Marine Corps. Each activity is responsible for developing its own training programs. MWRSPTACT makes available a limited supply of training materials and courses to be used at the local level upon request.

DISCUSSION

Training, formal or otherwise, in the three exchange systems' is currently pursued to differing degrees.

NAVY RESALE

Within Navy Resale, NRCA is responsible for providing system-wide policies and procedures for the training program, furnishing a comprehensive list of training aids available to Navy Resale activities and for evaluating the level of compliance with system-wide training policy and reports to COMNAVRESSO.

FSO commanding officers are responsible for ensuring that Navy Resale training policy is carried out in field exchange

activities and is effective. The OIC of each Navy Resale activity is supposed to have a training coordinator who is assigned to the personnel department.

The training coordinator is responsible for handling most of the actions required to create a viable training program. These actions include setting up the program and communicating and coordinating training performance; coordinating formal training or self-study courses; developing personalized training plans; and preparing a consolidated annual training plan/reports for timely submission to NRCA. Follow-ups show that job training plans have been completed on 60-65% of employees. Navy Resale training includes: (1) indoctrination training on general policies, benefits, etc.; (2) on-the-job training covering customer service, cash handling, other topics required for successful performance of the employee's current duties and for meeting minimal qualifications of higher graded performance, and group training covering such topics as EEO training, standards of conduct, new policies, etc.; (3) supervisory and management training for career develop- ment where individualized training plans are developed locally for all UA managers and supervisors, group training including such mandatory topics as EEO, standards of conduct, new policies, etc., and formal classroom training provided through the Navy Supply Corps School (NSCS), Navy Resale Functional Management Courses, and Navy Resale Career Academy Workshops; (4) Navy Resale System Self-Study Program where courses are done on the employee's own time and are made available on a "self-improvement" basis; (5) cross training for employees to achieve understanding of how the various exchange functions are operated and interrelate; and (6) management intern training at the Athens Supply Corps School or NRCA. Additionally, NRCA has a variety of audio video films currently in its library and listenings of tapes which can be obtained from commercial sources.

Navy Resale's Manager-In-Training and Management Intern programs provide a systematic method of introducing newly hired, experienced Resale professionals, College Graduate Trainees and upwardly mobile system employees to the knowledge and skills necessary to become effective professionals. These programs combine formal classroom training with on-the-job training. The Executive Development Program provides tuition reimbursement to those UA managers wishing to improve themselves professionally.

MARINE CORPS

Marine Corps has a limited centralized training function at the headquarters level and therefore delegates to local commands. The MWRSPTACT provides basic supervisory and customer service training materials to the field activities and a number of self-study courses are available.

They maintain a modest training reference library. Training materials available upon request include handbooks, manuals, lesson plans, video and audio cassettes as well as self-study courses on various elements pertinent to MWR operations. Locally developed training

programs and lesson plans of interest may be forwarded to MWRSPTACT for addition to the library.

Tuition assistance is encouraged if courses are job related and can improve job performance. Costs of these programs are borne by the local activity.

Warrant Officers (Marine Corps intake into MOS 4130, Exchange Officer), complete a Basic Exchange course in NSCS, Athens, Georgia. Enlisted personnel (MOS 4131) have no formal schools available. Training is provided through managed on-the-job training at Camp Lejeune, NC and Camp Pendleton, CA.

AAFES

Centrally planned, but decentralized in execution, the AAFES training program relies on exchange management to achieve training results in keeping with strategic objectives. Besides Training Coordinators, managers, supervisors, and specialists are also trained as instructors so they might function as field-faculty; they are content experts who individualize their instruction for their students.

Complementing the headquarters staff capabilities in needs assessment, training design, and faculty, are the field-based Training Coordinators who implement training resources and tailor programs to local requirements. The training program enables learned job skills to transfer to job application, thus yielding an informed work force, quality service, and satisfied customers.

The AAFES training programs offer learning options, both in curriculum and method through: formal courses; off-the-shelf training resources; self-study courses; on-the-job training opportunities; emerging computer-based training technology; major computer development projects for store and accounting efficiencies; and executive development. Of particular interest is "The Sales Associate Certification Program," requiring about 20 hours to complete its 12 modules. Sales associates are awarded a personalized name tag identifying them as service professionals, a certificate of achievement, and personalized business cards. There is a Sales Motivation Course covering "The Real Meaning of Service," "Selling Yourself," "You Are AAFES," "The Customer's Buying Cycle," "Building a Winning Sales Attitude," and job training plans for 23 hourly paid retail positions.

There is a Management Advancement Program--a three-year curriculum for college trainees and for currently employed management candidates selected from the AAFES Upward Mobility Roster. AAFES operates a Management Training Center at Fort Hood, which is where the selected UAs are given their basic training (4 weeks), and then they are transferred to a training location for OJT (19-34 weeks).

AAFES also offers a Professional Development Program which focuses on improving the leadership abilities and skills of general managers, area managers, main store managers, and food managers. They are located primarily on university

campuses. AAFES also conducts a Leadership Training Course for selected retail managers.

As well, the AAFES training program's view of the future sees the use of video teleconferencing and multi-media personal computer applications.

The AAFES Education plan offers funding for job-related courses, technical/skill courses, cross-career-cone training, high school equivalency certificate, and for associate, bachelor's and master's degree programs. Local Nationals are eligible for limited tuition assistance for job-related and technical/ skills courses, and for English-language training courses to help in their jobs. In its specialized training phase, the AAFES Education plan pays for professional or specialized courses, seminars, conferences, correspondence courses (commercial/ government), and certificate programs.

Because AAFES and Navy Resale already have sophisticated training programs in place, it would be comparatively easy for them, cooperatively with Marine Corps, to formulate generic courses to meet the needs of all the exchange systems. System unique requirements could be addressed either with modules developed by the particular exchange service or by the lead system with input supplied by others having a unique requirement.

All services have basic programs in place to train sales associates; however, a shortfall exists in Marine Corps, where no system-wide formal training is available for civilian managers or exchange employees.

RECOMMENDATIONS

11.2 Consolidation notwithstanding:

o All systems should maximize the use of computer based training, multi-media personal computer applications, and video teleconferencing; and

o A uniform training program should be developed with a basic core of required courses. This could be supplemented by several elective training courses tailored to the specific needs of individual exchange systems, functions, or individuals.

11.3

CAREER MANAGEMENT

BACKGROUND

Formalized career management programs of Navy Resale and AAFES are centrally managed by the personnel functions at their respective headquarters. The old Marine Corps Exchange (MCX) service developed and used a centralized Executive Management Program to fill exchange general manager positions but the program was cancelled 1 May 1990 due to the MCX consolidation with the Marine Corps Morale, Welfare and Recreation programs. A newly developed Senior Management Program (SMP) is to be implemented in January 1991 as a replacement.

The present PEOPLE Career Management System and methodology

has its roots in a number of practices and programs which were instituted in the later 1950's and have been consistently refined and updated in the intervening years. AAFES initiated a formal College Trainee Program in 1958 with a contingent of four new college graduates, and the Executive Management Program (EMP) dates from 1959. They currently manage the careers of approximately 6000 people worldwide. Their system has been highly centralized and is becoming more so every day. They recently assumed responsibility for managing the careers of all lower graded UA managers in CONUS, a function formerly performed by their exchange regions. While the technology which supports the career management process has become increasingly more sophisticated over the years, the AAFES mission and objectives have changed little. It remains AAFES' endeavor to staff management positions throughout AAFES worldwide with the best qualified people available on a timely basis, and in so doing maximize the opportunities for individuals to reach the highest personal levels of professional achievement possible. AAFES fills vacancies by promotion from within whenever possible. Only when current resources are insufficient to fill vacancies is recruitment outside the entry level used.

DISCUSSION

Navy Resale and AAFES have centrally managed career programs to insure that a pipeline of management expertise is constantly being developed to satisfy future needs. Both use signed mobility agreements to add the maximum degree of flexibility to the career program.

NAVY RESALE

At Navy Resale, the staffing portion of the career program is centralized at headquarters for EMP grades UA-10 through 12, SMP program grades UA-13 and above and certain UA-08 and 09 positions having unique requirements. Once a determination is made whether the vacancy will be filled by a directed placement of an employee under RIF, a management trainee who has completed training, an employee returning from overseas assignment or any other employee requiring placement, vacancies are advertised system-wide for competitive selection by the selecting official for the functional area or a SMP selection board for grades UA 13 and above. If neither of the above actions are taken, the vacancy will be filled by directed placement of a qualified mobile employee.

The placement and selection process described above considers the following factors in the selection/ placement decision: (1) knowledge, skills and abilities (KSAs) of qualified applicants/ employees; (2) performance in most recent assignments; (3) assignments required for career growth; (4) date/location of last rotation; (5) employee geographic/duty preferences; (6) employee personal considerations, i.e. health of family members, legal problems, etc.; and (7) the needs of the Navy Resale System.

Mobility is required for all employees to be considered for vacancies covered under the SMP

and EMP. An affirmatively signed mobility agreement acknowledging mobility status is a condition of employment or promotion into the above programs. Failure of a mobile employee to accept reassignment or relocation may result in termination. However, managers may submit requests for deferment of mobility for hardship reasons, via the chain of command, to COMNAVRESSO. Deferments must be requested by employees as situations arise and under all circumstances, must be submitted prior to receipt of verbal or written notice of official orders for reassignment or relocation. Any requests received after notification of orders will not normally be approved.

Other elements of career management are decentralized and are developed, implemented and monitored by the NRCA, a headquarters element, located at the FSO in Jacksonville, Florida. In accordance with DOD and SECNAV guidance, all managers and supervisors at headquarters and resale activities will counsel employees on matters pertaining to skills, attitudes and work habits. The counseling must include self-development, equal opportunity policy and promotion opportunities so that employees can improve their efficiency, performance and conduct.

To improve the counseling policy, the NRCA has developed a managers guide to career counseling and a career planning guide for employees. In addition to VHS video tapes on career management and other publications, the career academy conducts counseling workshops for managers and employees. NRCA has also developed approximately 20 individual development plans for managers and supervisors for system-wide use. It is estimated that over 90% of job functions now have related individual development plans. The academy has developed approximately 50 self-study training publications which are updated and revised as needed. Employees can also order a wide range of managerial/supervisory/functional courses from commercial sources.

The Navy Resale System provides funding to assist employees in obtaining supplemental education, college degrees, graduate degrees and professional designations to enhance their career growth and professional development. Managers are encouraged to widely publicize the tuition assistance program to reimburse employees for all job related educational courses.

Such career programs allow voluntary employee application in planning assignments for their career growth while providing centralized flexibility to staff vacancies in emergency or "hard to fill" situations. Supplementary benefits are provided to those employees who accept mobility and are members of the EMP and SMP.

In accepting membership in these programs, employees in the EMP are offered a number of fringe benefits not available to lower level employees such as: (1) additional leave at time of relocation; (2) salary protection and salary increments for directed placements; (3) RIF protection; (4) overseas return right protection; (5) special recognition of superior

performance; and (6) special training and professional development.

In addition to the above benefits, members of the SMP are entitled to: (1) consideration for annual bonus; (2) annual leave carry over up to 800 hours, paid in lump sum when leaving NAF service; and (3) merit increases dependent on performance.

Further, a Variable Housing Allowance (VHA) will be paid to any employee who is transferred to certain designated high cost areas on PCS orders. This includes employees who receive PCS orders to high cost areas after completing training in the management intern program. The VHA is paid at 100 percent for the first year and at an incrementally decreasing percentage each year thereafter for a maximum of three years (one-third reduction each year). There is no VHA paid after the third year.

MARINE CORPS

The Marine Corps SMP, a semi-centralized program scheduled for implementation approximately 1 January 1991, will be used to fill vacancies at grade UA-12 and above. Although the Marine Corps' SMP requires members to be mobile, it does not achieve optimum effectiveness since, due to the autonomy of command prerogative, MWRSPTACT cannot make final selections nor direct individual assignments or relocations except as a last resort measure. Fringe benefits are limited to: (1) payment of a performance bonus in addition to normal pay increments; (2) up to two weeks of professional training per year; (3) payment of a relocation bonus plus full JTR benefits for PCS; (4) ability to purchase extra life insurance; and (5) payoff of 25% of accrued annual leave in November of each year.

Marine Corps has no ongoing (uniform and/or centralized) college, intern or middle management career program. The lack of uniform system-wide career (middle) management, college recruitment, and intern programs will have a negative effect upon the future success of the MWR program, especially as assigned military and appropriated fund civilian personnel are phased out.

AAFES

The backbone of the AAFES Management/Executive workforce has been and continues to be the mobile UA employees. Mobile people are those who are willing to transfer to any AAFES location or facility worldwide. Mobility is voluntary at the UA 5-12 grade levels. While upward mobility is by no means restricted to mobile people (non-mobile people compete on an equal footing for promotional opportunities occurring within the local area), it is the mobile workforce that, besides occupying the majority of UA 5-12 positions in all locations, is typically the source of filling jobs in unaccompanied or hardship areas and in locales where few people would volunteer to work. In addition to enjoying a wider range of assignment possibilities and locations and an enhanced overall opportunity to attain the highest levels within the organization, the mobile employee is authorized a higher maximum vacation leave accrual (360 hours

vs 240 hours per year) and is afforded a higher retention priority than his or her non-mobile counterpart in the event of a reduction-in-force. Approximately 70% of the AAFES UA workforce at all grade levels is mobile.

AAFES' EMP membership is made up of mobile employees UA-13 and above. These people must remain mobile in order to retain EMP status, which accords its members retention priority in the event of a reduction-in-force, free physical examinations, some insurance benefits not available to other members of the UA workforce and, most significantly , a more favorable retirement program.

The Career Management Division administers promotion boards annually for each grade level from UA-13 through UA-15, and for UA-16 as needed. Promotion boards, which consist of 7 members, evaluate each eligible persons Career Management folder and prepare a ranked list of candidates from which the Commander, AAFES designates those to be promoted.

On occasion a person may find it necessary to request deferment of transfer. Deferments may be granted for up to 18 months under qualifying circumstances (i.e., family illness or other acceptable personal reasons, e.g., dependent high school senior, or enrollment in college on a part-time basis, a person may request deferment of transfer) and afford the employee temporary immunity from transfer without sacrificing "mobile" benefits. In some instances and for many of the same reasons, an employee may find it necessary to request a "compassionate transfer", i.e., a transfer to a particular geographic region or a specific locale which would not necessarily be in the best interests of AAFES. Such transfers, if feasible, are usually accomplished on a lateral or downgrade basis and with reduced transfer entitlements.

PCS transfers of UA employees in AAFES occur for several reasons: to fill newly established or created positions, i.e., as a result of reorganizations; to fill existing vacancies created by resignations, deaths, retirements, and the like; and as a result of the necessity to rotate (return to CONUS and replace) persons who have completed their prescribed period of overseas service. In fiscal year 1989 AAFES made 822 PCS transfers. The majority of these transfers occurred within CONUS, the next largest number to and from overseas.

The staffing specialists of the Career Management Division have varied functions in managing the careers of hundreds of UA employees. Among these is career counseling, the term to describe the one-on-one, usually face-to-face contact between a person and his or her career counselor to discuss such topics as career goals and progress, performance and competitiveness for advancement, and personal situation or problems in the interviewee's life impacting on his or her career. These specialists also administer reorganizations of functional entities within their jurisdiction and oversee training assignments (placement of employees into positions for which they are not fully qualified).

AAFES makes provisions for cross-training people from one career field to another in situations where, for example, there became excess people and/or limited advancement opportunity within a given career field and there are people qualified and interested in cross-training into fields with greater placement/advancement opportunities. Cross-training may also be necessitated, on a smaller scale, in the event of individual position abolishment, and can also be considered in response to employee requests for cross-training in order to enhance job satisfaction, better utilize employee skills and experience, and the like. Cross-training may be accomplished via a "training assignment" to a new position in the new field or by temporarily placing the person in an unassigned status for more intensive retraining.

A detailed analysis should be conducted to keep entitlements current with existing socio-economic conditions. Navy Resale and Marine Corps use the Joint Travel Regulations, Volume 2 as the implementing document for all relocation allowances. Although Volume 2 was not designed to be applicable to nonappropriated fund employees coverage was administratively adopted by DoD.

Within Marine Corps, because of the delegation to the lowest level and command prerogative, field activities often prefer to select their own employees if they are accountable for their operations rather than permit headquarters involvement.

RECOMMENDATIONS

11.3a Short of total consolidation, Navy Resale and AAFES should continue their respective career management programs. Marine Corps should implement their SMP with a view toward strengthening their mobility agreement and use of centralized recruitment and placement similar to AAFES and Navy Resale.

11.3b If consolidation is achieved, a new career management program should be created utilizing best features of each of the existing system's programs.

11.4

RECRUITMENT

BACKGROUND

The military exchanges are in direct competition with private industry for recruiting and retaining qualified personnel. As a result of high turnover the systems do not compete well with private industry, they must cultivate new sources of candidates. In a shrinking labor pool, infusion of new employees with fresh ideas is vital to the exchange systems continuing success as a major retailer. Recruitment continues to be one of the single most challenging aspects of their operations.

AAFES operates a number of recruiting programs. For Universal Annual (UA) positions, AAFES has a centralized external recruitment program to hire for entry level and training level positions. Hourly paid positions (HPP) at entry level are filled at the exchange level by AAFES outreach efforts or walk in candidates. In most cases, positions filled above the entry

level are filled competitively from internal candidates.

It is the basic policy of the Navy Resale System to promote within wherever possible, i.e., "grow and develop their own." To support this policy, most vacancies are advertised internally for competitive selection prior to external advertising.

Conversely all recruitment within the Marine Corps MWR system has been delegated to the local command level. Each command is required to established its own merit staffing program to fill vacancies by appropriate means. The new, Marine Corps NAFI Personnel Policy Manual, will for the first time implement a uniform merit staffing program Marine Corps-wide.

DISCUSSION

AAFES operates various styles of recruitment programs geared to the position being filled. For hourly paid positions (AS, PS, NA, types) at the entry level outside recruitment is the norm. Potential employees are hired from two sources: either AAFES' outreach efforts or they are walk in applicants at local exchange personnel offices. Position vacancies above the entry level are posted at the activity within each exchange so that current associates may apply for them prior to initiating external recruitment. This appears to be true for Navy Resale and Marine Corps activities as well. The AAFES centralized external recruitment program for entry level and training level UA positions receives between 500-600 resumes per month. They are scanned by a sophisticated applicant tracking system and a response provided to each applicant based on current/anticipated openings. These resumes/ applications are maintained for six months.

A staff of 5 recruiters working out of the Career Management Division at AAFES headquarters, travel nationwide to recruit primarily for entry level positions in Burger King management, retail, food, accounting, etc. Other UA's also support the recruiting endeavor by taking recruiting trips to university campuses. In 1989 176 individuals were selected for this program. Candidates for specialized and professional staff positions such as engineers, accountants, attorneys, computer specialists, etc., are identified by recruiters, screened and invited to the headquarters for interview.

During the 1989-90 recruiting season recruiters visited approximately 60 schools and interviewed 875 candidates on campus. AAFES hires approximately 200 trainees annually from the campus recruitment program and unsolicited write-in applications. They recruit on campus for entry level retail, food, personnel, auditing, accounting, distribution, and information systems positions. In 1989 the trainee payroll costs, training costs, moving and travel expenses for the college trainee program was $4,246,325 for the 195 trainees hired.

NAVY RESALE

Generally speaking, within

the Navy Resale system external recruitment by activities for UA positions, will only be used if a competitive selection is not made from internal applicants or placement of a qualified employee will not be made to fill the vacancy. For all non-management vacancies, i.e., grade UA-7 and below, and management vacancies, grades UA-8 and UA-9, external advertising will only be done within the general commuting area. Advertising outside the commuting area or elsewhere in the United States will only be done for grade UA-10 and higher management positions, positions where a shortage exists or when an effort is being made to avoid costly relocations of employees. The recruitment strategy will be determined by the activity's personnel department to maximize response and to be cost effective. SMP positions, i.e., grade UA-13 and above, and EMP positions grades UA-10 through UA-12 will only be recruited by NAVRESSO, and some grades UA-8 and UA-9 vacancies if requested by field activities. As with field activities, the headquarters advertising strategy is targeted for maximum exposure. NAVRESSO has 1 UA employee assigned specifically to college recruiting.

MARINE CORPS

A new merit staffing program being implemented Marine Corps-wide for all positions will achieve the necessary level of control and uniformity throughout the nonappropriated fund instrumentalities of the MWR system. The program will not, however, achieve optimum effectiveness since, due to command prerogative, MWRSPTACT cannot make selection decisions nor direct individual assignments or relocations except as a last resort measure.

The Marine Corps lacks a uniform career (middle) management, college recruitment, or intern programs which could contribute negatively to the future success of their MWR program, especially as they begin to phase out the assigned military and civil service personnel.

Filling positions internally contributes to good morale and allows current employees to apply for other positions or other geographic assignments desirable to them. It tends to encourage employees to play an active role in their assignments for career growth and development. However, a balance must be achieved. New people bring new ideas.

With the national labor pool shrinking, especially in the retail and service industry, all systems must actively cultivate new sources of candidates (i.e., local unemployment offices, senior citizen centers, handicapped rehabilitation and job assistance centers, etc.). Also, the systems must not forget applicants from high schools and community colleges who are our managers and workers of the future. The systems can benefit from their energy and enthusiasm.

RECOMMENDATIONS

11.4a Consolidation notwithstanding:

o Each system should continue their respective programs though looking at cooperative recruitment efforts, job fairs, etc.

o Each system should actively cultivate new sources of candidates due to the shrinking labor pool.

11.4b Under total consolidation, the centralized recruitment programs of AAFES and Navy Resale should be merged to form a new program using the best features of each.

11.5

EMPLOYMENT GENERAL

BACKGROUND

Categories of nonappropriated fund employees are regulated by DoD. With few exceptions all NAFI's are required to use either regular full-time or part-time (RFT or RPT), temporary full-time or part-time (TFT or TPT), or intermittent (INT) categories of employees. The use of part-time and intermittent employees offers management flexibility to staff an exchange according to patron demands. This insures that payroll dollars are spent most economically. However, in some competitive labor markets, it is extremely difficult to fill such positions. Prospective employees are in a position to hold out for full-time positions. In such labor markets the use of part-time and intermittent employees can be self-defeating because of high vacancy and turnover rates.

DISCUSSION

All the exchange systems currently use part-time and intermittent employees, but their success depends on local labor market conditions.

The numbers of employees by category in each of the exchange systems is depicted in the following table.

NAF CIVILIAN EMPLOYEES OF THE DOD EXCHANGE SYSTEMS				
		AAFES	NAVY RESALE	MARINE CORPS
Universal Annual (UA)				
	FT	6,072	1,884	559
	PT	19	23	4
	INT	3	16	0
Administrative Services (AS)				
	FT	6,294	2,987	329
	PT	2,134	603	185
	INT	989	305	203
Patron Services (PS)				
	FT	5,235	3,065	1,186
	PT	9,845	4,150	670
	INT	9,989	3,039	720
Crafts & Trades (NA, NL, NS)	FT	8,393	4,962	892
	PT	7,005	2,191	505
	INT	12,457	1,530	544
TOTAL		68,435	24,755	5,797
PERCENTAGE PT & INT/FT		62/38	48/52	49/51

RECOMMENDATION

11.5 Individually or collectively, the systems should use part-time and intermittent employees to the maximum extent feasible, but individual exchange managers should be given flexibility in deciding how thoroughly to use these programs since local labor markets vary considerably throughout the country and overseas.

11.6

UTILIZATION OF MILITARY PERSONNEL

BACKGROUND

The assignment and utilization of military personnel in each of the three exchange systems was reviewed. A total of $15.8 million in payroll costs is associated with the assigned military personnel of the three system. The table below depicts the distribution.

FY89 MILITARY PERSONNEL/PAYROLL				
	AAFES	NAVRESSO	MARINE CORPS	TOTAL
OFFICERS	79	57*	14	150
ENLISTED	25	94*	127	246
WARRANT OFFICER	1	-	10	11
TOTAL	105	151*	151	407
PAYROLL (Millions)	$7.5	$4.624*	$3.635	$15.759

*(Includes Half of 88 Officer/23 Enlisted Split 50/50 Between Exchange & Commissary Duty & Associated Payroll Costs)

Military personnel are utilized in the exchange, food and hospitality, and recreation programs throughout the Marine Corps. They are an integral part of support for mobilization plans.

Military personnel have occupied key executive and management positions in the Navy Exchange Program since its inception. Prior to 1985 in Department of the Navy, both officer and enlisted personnel were assigned to exchanges under the command of the Navy Resale System. In 1985, exchanges were consolidated with commissaries into Navy Resale Activities commanded by officers and petty officers in charge. In 1987, command and control of Navy Resale Activities was transferred to local Commanding Officers, with primary support and technical control provided through the Navy Resale chain of command.

DISCUSSION

Historically, DoD and Congress have tended to view a reduction in resale military billets as a means of reducing appropriated fund support of the exchange systems. This trend will most probably intensify with anticipated major cutbacks in the DoD budget.

MARINE CORPS

Military officers and enlisted personnel working in the Marine Corps exchange system provide an additional labor pool of highly qualified retail personnel. Using them in key management positions reduces expenditures of nonappropriated funds for those billets.

Any reduction in the active duty 4130/31 MOS structure would have an adverse impact on the Marine Corps' ability to provide exchange support on short notice to expeditionary forces and increase expenditures of nonappropriated funds on civilian salaries.

In addition, the Marine Corps believes that if Marines were no longer assigned to exchanges it would be impractical to provide exchange support to debarking Fleet

Marine Force Units. Exchange support provided by other services during early developments in an expeditionary environment would be difficult since the Marines are the only service that currently maintains a cadre of military personnel specifically trained to operate in an expeditionary field environment.

The Marine Corps has both civilian and military exchange or retail officers/managers who report to the MWR Directors of their respective activities. In the case where a small activity might have a dual hatted individual (MWR Director and retail head), the individual reports directly to the commander. At the MWRSPTACT the military are assigned to various operational branches (Services Operations, Food & Hospitality, and Recreation). An O-6 presently serves as the Deputy Director of the Activity.

NAVY RESALE

The number of authorized military billets in the Navy Exchange Program has undergone drastic reductions in recent years, from a total of 657 in FY71 to 207 in FY90. Additionally, while the 657 in FY71 represented the full time Navy exchange billets, 111 of the current 207 billets are considered 50% Navy exchange/50% commissary billets as a result of the consolidation of the exchanges and commissaries in October 1985.

The current Navy policy provides for use of military personnel in support of Navy exchanges:

(1) where effective executive control and essential command supervision cannot be provided by the assignment of civilian personnel;

(2) when required for deployments of at locations where qualified civilians are not available either through the local labor market or through an existing centrally managed career management program; and/or

(3) for the purpose of rotation, training and career progression when it can be clearly shown that such opportunities do not exist in other activities.

In Navy Resale the exchange officer/manager reports directly to his or her respective base commander and concurrently to the NAVRESSO field support office. They are intimately involved with their local commands and attend consumer group meetings, commander's staff meetings, etc.

The Navy believes that by placing civilians in key positions, a cadre of senior civilian managers could be developed. Both AAFES and Navy Resale agree a greater degree of control over the individual's placement, education and training in the initial phase of employment would ensure a more rapid development of talented and effective managers with an opportunity for steady growth and career progression.

However, the bulk of the military billets are located at overseas or isolated locations where an adequate skilled civilian labor force does not

exist. Civilianization of these billets is not feasible due to the excessive costs involved in attracting qualified civilians to these undesirable locations. Additionally, it is essential that military personnel be trained in resale operations in the United States to provide a nucleus form which to draw for these isolated areas.

It is also the Navy's belief that top management resale positions continue to be essential for Supply Corps officer career development in the Retailing functional subspecialty. Field operational experience in retailing is vital to meaningful and successful headquarters/operational assignments in the future. The wide range of responsibility is all facets of business management to which an exchange officer is exposed early in his or her career is unmatched in any other subspeciality within the Supply Corps. These billets are true operational management positions with large, physically dispersed subordinate outlets. The incumbents are required, on a continuing basis to make decisions involving substantial commitments of resources (money, manpower and material) and to be responsive to trends affecting their operation. The expertise acquired in a broad spectrum of supply disciplines including accounting, forecasting, budgeting, material distribution, acquisition contracting, inventory control, marketing, and personnel administration is directly transferrable to subsequent assignments in other functional areas.

Further, Navy Resale feels the success of the Navy Exchange Program, particularly system integrity, is directly attributable to the use of Supply Corps officers in top management positions. Their professional skills and business management ability, coupled with an understanding of the needs of service personnel and their dependents, enables them to manage field activities in a highly effective manner. They are required in resale billets not only because of the educational requirements, but for the military interface required at the local command level and upper military echelons. The deletion of a significant number of military personnel occupying executive billets without highly qualified top-level civilians in place or in the pipeline would severely degrade mission performance.

The Ships' Stores Afloat Program is a unique retail entity that provides a vital quality of life service to the men and women aboard ships while providing a career path for a specialized cadre of Navy enlisted personnel. Ship's servicemen comprise the vast majority of resale enlisted personnel. There are presently 103 ships stores billets authorized. Retailing and services are functions inherent in the Ship's Serviceman rating. A reduction in resale shore billets would negatively impact an already unsatisfactory sea/shore rotation pattern within the rating, while substituting shore billets in non-related areas would only lead to lower levels of professional expertise. Normal career path rotation is from a ship to a Commissary or Exchange

ashore.

This program has no impact on the consolidation issue and should continue to operate without interference. However, some career pathing must be developed to assure ship's servicemen who would have normally had shore duty with the Exchange have a meaningful related assignment.

AAFES

AAFES has effectively eliminated most of the assigned operational level military billets with the exception of the Western Pacific activities (the Philippines, Korea, Japan and Okinawa). The local commands at these sites have been reluctant to relinquish the command prerogative aspects. They have operated more than adequately with assigned military at their HQs and the Pacific and European HQs.

The future success of the system(s) will depend on their individual or collective ability to directly control the operations of the retail activities and their personnel. A potential exists in the Navy and somewhat less in the Marine Corps systems for conflict between the consistent application of the goals of the exchanges (i.e., savings to the patron, improved customer service, and providing funding to the MWR Program) because of "serving two masters". The exchange officer/manager or retail head should have only one superior through which he or she is accountable.

RECOMMENDATIONS

11.6 If consolidation were effected, assigned military should be retained in key management positions at the new organizational headquarters with billets proportionately distributed among the services. Additional officer and enlisted billets would remain at remote and isolated and some overseas locations.

11.7

COMPENSATION

BACKGROUND

The continuing inability of our exchanges and the NAF system as a whole to adequately compensate our employees has an adverse impact on recruitment and retention.

PL 92-392, enacted 19 August 1972, established the NAF Federal Wage System for prevailing rate Crafts and Trades (CT) employees. The Office of Personnel Management (OPM) determined basic policies, practices, and procedures for the operation of the NAF Federal Wage System, setting forth administrative and operating details in Federal Personnel Manual (FPM) Supplement 532-2. OPM designated DoD as the lead agency responsible for fixing and administering rates of pay for DoD NAFI hourly paid employees. Although the law applies only to NAF CT employees, for purposes of uniformity, DoD administratively extended the provisions of PL 92-392 and FPM 532-2 to NAFI Administrative Support (AS) and Patron Services (PS) employees. The DoD also provided that rates of pay for Universal Annual (UA) employees

would be administratively fixed and adjusted equally with rates of compensation for appropriated fund employees in positions of comparable difficulty and responsibility, subject to the General Schedule (GS). The DoD Wage Fixing Authority (WFA) was established to oversee the pay setting function for DoD components. Policy and procedures are contained in DoD 1401.1-M, Personnel Policy Manual for NAF.

DISCUSSION

P.L. 92-392 requires that rates of pay for CT employees be set on the basis of a survey of the prevailing wage rates paid by private employers to full-time employees in a representative number of retail, wholesale, services, and recreational establishments similar to those in which NAFI employees work. DoD extended this requirement to AS and PS employees such that rates of pay for hourly paid employees shall be determined on the basis of the duties and responsibilities of the jobs and commensurate with prevailing rates in the immediate locality of employment for comparable work in similar enterprises in the private sector. Locality wage surveys, at approximately annual intervals, serve as the basis for adjustments of pay rates.

The WFA assisted by a Local Wage Survey Organization (LWSO) established in each local wage area conducts an annual wage survey and determines wage rates for all NAFI hour paid positions in each of over 125 wage area locations throughout the United States. Private sector retail, wholesale, services, and recreational establishments selected to participate in the locality wage survey are determined by the Bureau of Labor Statistics based on their eligibility under applicable Standard Industrial Classifications for each wage area.

There are a large number of occupational skills used in the many different NAFI activities within DoD. Wage data is not obtained for every skill during a wage survey. Rather, the OPM and DoD-WFA have prescribed a list of jobs that represent a wide range of occupations common in both skill and responsibility to private employers and NAFI activities for which wage data "must" be obtained. Certain "optional" jobs can also be surveyed if the WFA considers them essential to the wage fixing process. These jobs are the only skills that can be surveyed for purposes of establishing wage rates for NAFI employees.

NAFI wage rates and schedules are developed by the WFA. In doing this, they apply standard mathematical and statistical techniques to the wage date obtained in the survey that accounts for the varying degrees of skill and responsibility in NAFI jobs.

A positive aspect of the present system is that there appear to be ties to locality pay levels for hourly paid employees, rather than like the UA's which is geared towards a national salary plan (the General Schedule).

The overwhelming downside of the present system, however,

includes the constraints which are placed on the system in the form of pay "caps"; the pay administration practices required (i.e., very narrow ranges for grades in hourly and UA schedules; premium pay; time-in-step requirements; and small salary increments); and the inability to more broadly apply private sector incentives. These unrealistic practices hamper the exchanges ability to adequately (and differentially) reward employees for performance. Inability to use the same incentives as the private sector, such as commission pay for sales clerks and bonuses for managerial and supervisory personnel, also hampers efforts to motivate employees to greater productivity.

Because of the grade level assigned to survey jobs and statistical techniques used to develop wage schedules, rates for individual jobs often do not reflect rates for similar position in the survey area.

Federal wage "caps" and "freezes" imposed over the last several years have resulted in NAF wages, in many areas, falling considerably behind the prevailing rates paid to their private sector counterparts. Special wage rates can however be requested for specific types of jobs in individual wage areas when the maximum NAFI rates are so far below prevailing rates for comparable positions in the private sector as to seriously handicap agencies in recruiting and retaining employees. However, obtaining approval is a time consuming and cumbersome process often taking a year or more. Each of the systems use commission pay plans which provide employees the opportunity to regularly earn more than employees on a straight hourly rate, but in line with rates paid for similar work in the local community.

OPM has listed the major agency payment methods that are on other than a time rate basis, such as commission or piece rate in FPM Supplement 532-2. The following paragraphs describe those applicable to the three exchange systems.

AAFES

The following page reflects the various commission (percentage of sales) rate for Army and Air Force Exchange Service (AAFES) installation exchange activities.

Occupation	Allowable commission percentage range
Automotive mechanic	40-65
Barber	57-85
Beautician	50-70
Food service worker (snack stand attendant)	9-10
Watch repairer	60

The rates are based on industry practice on a nationwide basis. (For Automotive Mechanic, a survey of local establishments is made.) Percentage rates adjusted in accordance with 12 - week and annual reviews of operating results, hours and earnings. Additional compensation based on total activity sales may be applied to supervisors of automotive activities, barber shops, and beauty parlors.

MARINE CORPS

Commission (percentage of gross sales) rate for Marine Corps activities cover Automotive Mechanic, Barber, Beautician, Service Station Attendant, and Shoe Shiner. The rates are on local wage surveys. Additional supervisory compensation based on total activity sales may be granted. Piece rate for Dry Cleaner and Presser is also paid at certain Marine Corps activities. Their rates are also based on local wage surveys with additional supervisory compensation based on total activity sales.

Employees may be paid two separate piece rates - one rate for a certain quota of piecework and a second rate for piecework in excess of that quota. Bartenders, Food Service Workers (Busboys), Waiters and Waitresses are on an set hourly rate plus tips.

NAVY RESALE

The Navy exchanges use several different types of incentive pay plans. The largest number of employees on incentive pay are on a commission system. Straight commission pay plans are used for Barbers, Beauticians, and Automotive Workers. These employees are guaranteed minimum wage plus a specified percentage of sales which they generate themselves. Another form of incentive pay used by Navy exchanges is the piece rate system. Typically, these laundry and dry cleaning pressers, seamstresses, and tailors are guaranteed a certain hourly rate plus specified amount for each article which they produce.

The following outlines the specifics of the NAVRESSO plans:

Occupation	Allowable commission percentage range	Hourly Rate Plus Commission
Automotive mechanic..........	60-70	$2.52 plus 50 percent.
Barber	55-94	Range from $0.13 plus 70 percent to $2.50 plus 75 percent.
Beautician	50-75	From $0.43 plus 70 percent to $1.70 plus 30 percent.
Radio/TV repairmen	50-65	From $3.46 plus 65 percent to $3.79 plus 10 percent.
Shoe shiner	62-75	From $1.10 plus 90 percent to $1.90 plus 65 percent.
Watch repairer	50-90	From $0.72 plus 60 percent to $3 plus 50 percent.
Cobbler	35-62	
Engraver	65	
Tailor/seamstress	60-73	

Laundry and Dry Cleaning Operators

Flat piece rate	Hourly rate plus piece rate
50-70 percent	$1.76 to $2.13 per hour plus variable piece rate.

Earnings are set so as to be comparable to those of private industry and regular schedule employees performing essentially the same level of work. Private industry data is collected during regular surveys if possible.

Ideally a more market-driven compensation system would be preferable. Local or regional bases could be established for hourly-paid positions with delegated approval authority at the NAFI headquarters element level. There appears to be movement afoot within the Federal government toward a national salary plan for certain GS employees possibly with area differentials within CONUS for high-cost areas. This would also be a plus for the NAFIs as they have traditionally administratively adopted the same policies set down for the GS.

As a result of the test and evaluation of Military Department and Defense Agency NAF pay banding under Project EXPO, a DoD NAF Pay Band System was developed by a committee representing the

nonappropriated fund interests of the Military Departments, the NMPC, the AAFES, the Navy Resale and the Marine Corps.

The report of this sub-committee on NAF Pay Systems and Personnel Policy containing guidance on implementation of the new DoD NAF Pay Band System was provided to the Acting Deputy Assistant Secretary of Defense (Civilian Personnel Policy) on 11 July 1990. He approved the System and issued an implementing memorandum to the Deputy Assistant Secretaries of the Military Departments and the Commander, Army and Air Force Exchange Service. The system is to be implemented beginning 1 October 1990, through 31 March 1992 and will cover all NAF positions except Crafts and Trades (blue collar positions) where pay is covered by statute.

Since change to the Crafts and Trades system would require legislation, DoD will be left to pursue that end and the new system will cover only white collar positions. The existing UA, AS and PS systems will be used as the basis for the pay bands with a prevailing rate determination (for AS/PS positions) made to closer align them with the local market conditions. This will be accomplished by the NAF Technical Staff of the DoD Wage Fixing Authority. The NAF Technical Staff was also tasked with developing procedures to reduce the number of wage areas which would result in lower costs to the NAFI's.

In developing the pay band structure the committee reviewed the density and types of position in the current AS/PS system. It was readily apparent that the levels AS/PS 1-4 contained the vast bulk of retail sales positions. Even though consideration was given to development of a separate retail sales pay band, the committee decided that a single system would be responsive to all needs and there was no merit in establishing a separate occupational pay band for retail sales or any other specialty.

The resulting bands are:

WHITE COLLAR PAY BANDS

NF LEVEL	SALARY RANGE	GRADES COVERED
1	Prevailing Rate	AS/PS-1 through AS/PS-4
2	Prevailing Rate	AS/PS-5 through AS/PS-6
3	TBD to $32,000	AS/PS-7 through UA-8
4	$24,000 to $50,000	UA-9 through UA-12
5	$42,000 to $78,200	UA-13 through UA-15
6	$69,000 to CAP	SES 1-4 & UA-16 to UA-18

The recent Supreme Court decision (Ft. Stewart schools) declaring wages and benefits as negotiable subjects for bargaining is a significant area of concern. It has major implications for the exchange systems and impacts on their ability to meet MWR requirements.

RECOMMENDATIONS

11.7a Proceed with implementation of the pilot, DoD NAF Pay Band System to be evaluated prior to final approval.

11.7b If final approval is given to the pilot DoD should seek legislative relief from the statutory limitations placed on Crafts & Trades positions to allow inclusion in the DoD NAF Pay Banding System.

11.8

POSITION CLASSIFICATION

BACKGROUND

AAFES had a centralized classification program well before passage of Public Law 92-392. Since the passage of the public law and the inclusion of AAFES under the Department of Defense (DoD) umbrella, classification and grading has been done in accordance with DoD 1401.1-M-1 and OPM Classification Standards. AAFES developed and issued supplemental guidelines and procedures which provide regulatory guidance by which program goals and procedures are transmitted through the AAFES system worldwide. This guidance also details the specifics involved in such areas as job description preparation, desk audits, job analysis and evaluation, standard and nonstandard jobs, job classification reviews, and job description certification.

Position classification

within the Department of the Navy (Navy Resale and Marine Corps) nonappropriated fund system is performed in accordance with DoDI 1401.1-M-1, "Job Grading System for Nonappropriated Fund Instrumentalities" for AS and PS positions. The OPM standards are used for UA positions when they can be directly applied. Navy Resale has developed standards for those positions which cannot be classified by OPM standards.

DISCUSSION

AAFES

Application of DoD NAF, OPM, and supplemental AAFES policies and procedures has provided AAFES with a system of evaluating positions on their own merits and ranking a total of approximately 70,000 U.S. positions within a hierarchy of many supervisory levels. The few job grading appeals submitted, most of which are won by AAFES, attest to the integrity and reliability of this system. Nevertheless, the practice of differentiating jobs contributes to the proliferation of individually identified positions and job descriptions. AAFES currently maintains some 10,000 job descriptions for its approximately 70,000 U.S. citizen employees.

AAFES-created volume jobs may cover any range of average monthly sales volumes (AMSV) and grades up to the UA-15 level provided they are properly grouped within the applicable occupational structure. Criteria governing AAFES volume jobs are established within the general framework of both the DoD and OPM manuals. In addition, AAFES considers comparability with commercial counterparts, upward mobility objectives, retention needs, experience, skill levels needed to function competently, and general requirements of operations and executive management.

AAFES considers a UA or HPP job description "standard" when the position may be used at any exchange/area exchange worldwide. Positions assigned to overhead facilities are not considered "standard".

AAFES has developed a total of 47 volume standards primarily based on sales volume and various other contribution factors such as annexes supervised, etc., which are reviewed biennially to update the grades of these positions.

NAVY RESALE

Use of OPM, DoD and Navy Resale standards has provided consistency in grading positions system-wide for Navy Resale. It enables them to identify areas of strength and weakness in staffing (over/under), making suggestions for improvement and providing assistance where required. Managers, supervisors and employees are fully informed on relationships among all positions in their organizational unit and the relation of the work of each position to the functions of the unit as a whole. The system provides the ability to review organization structures and to determine whether an optimum blend of efficiency and economy to meet mission requirements, position ceiling and good human resources utilization is met. The present system assists in eliminating unnecessary layering and fragmentation of duties and responsibilities.

There are some drawbacks; however, in that the OPM standards do not address business-oriented activities such as those in which exchanges are engaged. They are also difficult to apply and higher grades are limited, thus contributing to recruitment and retention difficulty. The majority of the standards are outdated.

Until recently, Navy Resale retained classification authority for all nonappropriated fund position within the Resale System. Last year they began to delegate classification authority to the Field Support Offices (FSOs) for AS, PS, NA, NL and NS positions. Navy Resale's personnel managers in the field are generalists and have only limited time to devote to classification. To assist them, NAVRESSO has made extensive use of standardized position descriptions for all positions.

Thirty-two UA positions are graded using volume-allocated standards developed by NAVRESSO. Most use sales volume as the criterion, although a few variations exist (e.g., gallonage and labor sales for automotive positions; sales and levels of complexity of department for buyers; sales, distance, number of selling outlets and locations for general managers, etc.).

MARINE CORPS

Marine Corps uses OPM or DoD standards in all classification actions. There are no Marine Corps volume standards in use at this time. Classification authority is delegated to the local MWR activity when they can provide a qualified individual to perform classification duties. The present classification is unacceptable because most of the MWR jobs within the Marine Corps are retail and service related and not addressed in OPM classification standards.

Under the DoD NAF Pay Banding System the sub-committee developed a narrative description of each pay level, which, together with a hierarchy of position guides, enables a set of duties to be placed at the appropriate pay level. This simplified classification system has proven to be extremely well receive by all activities presently participating in EXPO tests, and, is strongly endorsed as an alternative to the current classification-by-rigid-standards-system.

RECOMMENDATION

11.8 Proceed with implementation of the pilot DoD NAF Pay Banding System of classification to be evaluated prior to final approval.

11.9

LABOR-MANAGEMENT RELATIONS

BACKGROUND

Labor-Management Relations within the Marine Corps is conducted in accordance with 5 U.S.C. Chapter 71 (Federal Service Labor-Management Relations Statute), DoD CPM 711, CPI 711, and MCO 12711.1. Essentially, the program uses a decentralized approach to deal with the basic elements of the function, while retaining centralized oversight and control

of the key elements which have potential for impact outside the local command.

The development of the union movement in AAFES is, of course, tied to the growth of the union movement in the Federal government. With the passage of the Civil Service Reform Act and the granting of statutory rights to unions in the Federal government, one union moved quickly to become the first to consolidate their bargaining units. Two others took similar actions in 1981 and 1982. The effect of these consolidations was to raise the level of recognition to the Commander, AAFES and obligate the Commander to negotiate changes in working conditions dictated at his level.

To cope with these legal obligations and the myriad of other responsibilities, in 1982 centralized control/support was organized at Headquarters, AAFES level under the Director, Personnel (now PEOPLE Resources). Following that action, in March 1986, the Commander, AAFES redelegated the responsibility to set labor policy and to administer the AAFES labor-management relations program from the General Counsel to the Director, PEOPLE Resources.

DISCUSSION

Within the Navy Resale community, labor-management relations is an integral part of the personnel function and is administered by FSO or exchange personnel managers or assistants. There are 55 bargaining units representing approximately 16,000 employees at 73 separate Navy Resale locations. The NAVRESSO HQs staff of 4 Labor and Employee Relations Specialists provide expert guidance and assistance to the field personnel managers and, on an as needed basis, act as chief spokespersons during contract negotiations or as management's representative in arbitration cases at the local level.

Within the Marine Corps there are currently 16 bargaining units at 14 commands with approximately 7,383 NAF employees represented. At 12 commands, the units include the entire MWR function. Action has been initiated to achieve the same result (i.e., one unit composed of all MWR NAF employees) at the other two commands. Some units include employees of other NAFIs, such as Child Development Centers and Billeting Funds. Some units include temporary and intermittent employees, while others do not.

Labor-management relations is primarily a responsibility of the local command. This includes negotiating and administering collective bargaining agreements, and maintaining the day-to-day relationship with the union. Two commands have full-time Labor Relations Specialists. Most other commands use the NAF personnel Officer and staff, MWR Director, Deputy Director, or other line managers to fulfill the collective bargaining obligation. At most commands, there are a number of people who are routinely involved in the process on a part time basis.

Labor-management relations support, which may include negotiation and arbitration representation, is obtained from a variety of sources, including

local command civil service personnel offices and staff judge advocates, Eastern and Western Area Counsel Offices (EACO/WACO), Marine Corps Headquarters, and regional offices of the Office of Civilian Personnel Management (OCPM). One full-time specialist at HQMC devotes approximately 50% of his time to labor-management relations support, and coordinates support from other labor-management relations specialists at HQMC and other organizations.

Representation in cases before third parties such as the Federal Labor Relations Authority, Federal Services Impasses Panel, and the courts is provided by HQMC, EACO/WACO, or OCPM, as appropriate. Training in basic labor-management relations, negotiations, and management representation is provided by HQMC or OCPM, and is also available from a variety of commercial sources.

In AAFES the Director, PEOPLE Resources, sets labor policy and administers the labor-management relations program through the Chief, Labor Relations Division and a staff of 4 specialists. There are 24 bargaining units representing 28,828 employees.

For Federal labor law purposes, it has been established in case law that AAFES is a primary national subdivision (PNS) of the DoD with the Commander, AAFES being designated as the "head". The legal effect is to place AAFES, for labor relations purposes, on the same level as the Army, Air Force, Navy, National Guard Bureau and the Defense Agencies (i.e., Defense Logistics Agency, Defense Mapping Agency, Defense Nuclear Agency, Defense Contract Audit Agency, Defense Communications Agency, and Defense Audio-Visual Agency). **AAFES has the unique distinction of being the only nonappropriated fund instrumentality that is designated a PNS.**

Beginning with the National Association of Government Employees (NAGE) on 4 June 1979, and followed by the American Federal of Government Employees (AFGE) on 13 November 1981, and the National Federal of Federal Employees (NFFE) on 12 February 1982, the three unions representing 86.5% of organized employees successfully consolidated their respective certifications. This has in effect moved recognition from the field or operating level to the command or headquarters level thus permitting each of these three unions to bargain on behalf of its respective employees with the Commander, AAFES. DoD now reviews these union's master agreements for compliance with law and regulations with the Commander, AAFES reviewing and approving only those agreements where the level of recognition remains at the field or operational level.

RECOMMENDATIONS

11.9a A consolidated exchange instrumentality should enjoy primary national sub-division status under the statute as AAFES presently enjoys.

11.9b Short of full consolidation, the approach of focusing the labor-management relationship at the command level to deal with local matters, with support and representation in third party cases by headquarters

has worked well for NAVRESSO and the Marine Corps. Therefore, responsibility for labor relations issues must remain centralized at their headquarters' level. AAFES would continue to enjoy its primary national sub-division status.

11.9c Amendment to PL 92-392, HR 3139 (dealing with portability of benefits) or other legislation as necessary should be proposed to preclude bargaining on wages and economic fringe benefits for NAF employees.

SUMMARY OF RECOMMENDATIONS

Our review of current personnel policies and procedures has shown a number of ways in which these areas could be improved. In the area of incentives, all the systems have adequate programs. A very important area that Marine Corps and AAFES should closely monitor are the gain sharing programs in Navy Resale. If they show productivity increases, better morale and enhanced customer satisfaction, all systems should implement. AAFES should review the Marine Corps and Navy Resale use of performance based incentives linked to annual performance evaluations. If a full consolidation occurs, a new incentive and performance awards program should be developed using the best features of the AAFES and Navy Resale programs.

One very important and redundant area is the use of three entirely separate and different training programs. A uniform training program should be developed with a basic core of required courses. This could be supplemented by several elective training programs tailored to the specific needs of activities, functions, or individuals. Consolidation notwithstanding, Navy Resale and Marine Corps should follow AAFES' lead in investigating the use of computer based training, multi-media personal computer applications, and video teleconferencing.

Each system operates its own Career Management Program. Short of total consolidation, AAFES and Navy Resale should continue its respective career management programs. Marine Corps should continue toward implementation of their SMP but consider modifications modeled after the NAVRESSO and/or AAFES systems. If consolidation is achieved, a new career management program should be created utilizing best features of each of the existing system's programs.

Recruitment is a very critical area to the exchange systems. Consolidation notwithstanding, all systems must actively cultivate new sources of candidates (i.e., local unemployment offices, senior citizen centers, handicapped rehabilitation and job assistance centers, etc.). Also, the systems must not forget the applicants from high schools and community colleges who are our managers and workers of the future and the systems can benefit from their energy and enthusiasm. AAFES operates a modern professional external recruitment system and is continually working to modify programs to remain competitive in today's shrinking labor market. Under a partial or total consolidation, efficiencies could

be had through a joint recruiting effort. Simply merging the present AAFES and Navy Resale staffs would result in efficiencies by eliminating the duplication of effort and further broadening the candidate pool.

Individually or collectively, the systems should use part-time and intermittent employees to the maximum extent feasible, but individual exchange managers should be given flexibility in deciding how thoroughly to use these programs since local labor markets vary considerably throughout the country and overseas.

An area of considerable contention is the retention of assigned military in the exchanges systems especially the Marine Corps and Navy Resale. If consolidation were effected we recommend assigned military be retained, as a minimum, in key management positions at regional/area exchange and headquarters levels distributed propor- tionately among the services. Certain remote and isolated and some overseas locations would also be authorized officer and enlisted billets. Many of these military occupy exchange management positions which would require replacement by civilian managers. This would result in expenditure of NAF while reducing APF by about half but it will provide top management with greater control over placement, education and training of the incumbents. It will ensure more rapid development of talented and effective managers. Marine Corps and Navy Resale positions should be carefully scrutinized to assure there is no significant impact on their ability to respond to deployment and contingencies.

Another major area of concern was the failure of the current compensation system to assist the exchanges in the recruitment, reward, and retention of qualified personnel. The DoD has approved implementation of a pay banding system on a pilot basis which hopefully will ameliorate many of the compensation problems we have been facing. A negative aspect to this however, is that the blue collar (Crafts and Trades) employees are not included in the NAF Pay Band System because their pay is covered by statute. Therefore, DoD should seek legislative relief to allow their inclusion in the DoD NAF Pay Banding System.

A final area of importance to the NAF employment system of the exchanges is labor relations. A totally consolidated exchange instrumentality should enjoy primary national sub-division (PNS) status under the statute as AAFES presently has.

If partial consolidation occurs, the approach of focusing the labor-management relationship at the command level to deal with local matters, with support and representation in third party cases by headquarters' staff, has worked well for Navy Resale and the Marine Corps. Therefore, responsibility for labor relations issues should remain centralized at their headquarters' level. AAFES would continue to enjoy its primary national sub-division status.

CHAPTER 12

EMPLOYEE BENEFIT PROGRAMS

OVERVIEW

Because of the significance of the employee benefit programs (welfare, benefit and retirement) of the DoD exchange systems, the study group believed the discussion should be highlighted in a separate chapter.

The nonappropriated fund (NAF) welfare programs of the three military exchange systems within Department of Defense (DoD) are broadly regulated by Department of Defense in "Personnel Policy Manual for Nonappropriated Fund Instrumentalities", DoD 1401.1-M. DoD requires that all eligible NAFI employees be afforded the opportunity to participate in retirement and insurance programs offered within DoD. This means that unless otherwise required by Federal statutes or other specific provisions in DoD regulations, regular full time (RFT) employees of NAFIs who are U.S. citizens, U.S. nationals, or permanent resident aliens of the United States employed in the United States shall be offered, as a minimum, the retirement and insurance programs available.

DoD prohibits retirement or insurance plans or changes to existing plans from exceeding the benefits authorized by the Congress for civil service employees who are covered by the U.S. Office of Personnel

Management (OPM) rules and regulations concerning employee benefits. The exception to this prohibition is that retirement or insurance plans in effect on 1 January 1976, that exceeded the benefits authorized by Congress for such employees may continue with those benefits.

12.1 WELFARE BENEFIT PROGRAMS

BACKGROUND

AAFES, Marine Corps and Navy Resale each have separate NAF welfare programs which are similar in many respects; however, there are a number of differences in plan design, cost sharing, eligibility, funding and administration. NAF employees are not covered under the Civil Service welfare programs. NAF welfare programs do not receive any appropriated fund support.

All three exchange systems offer voluntary participation to regular full time (RFT) employees. Marine Corps offers voluntary participation to regular part time (RPT) employees as well.

Unlike the AAFES and Navy Resale programs, Marine Corps welfare programs cover both exchange and other NAF employees (i.e., MWR, Billeting Fund, Child Development Centers, Aero Clubs, etc.). It is assumed that employees outside the exchange system will not be part of a consolidated exchange program.

DISCUSSION

Plan design differences exist between all three systems as reflected in Appendix G., page G-1.

The welfare programs offered by all three systems include health (medical and dental) and life insurance benefits. Navy Resale offers disability in its welfare program. AAFES offers disability benefits through both welfare and retirement plans while the Marine Corps offers its disability through its retirement plan only. Significant differences are also reflected in welfare coverages for retired employees.

In all three systems, participating employees share in the cost of most plans. Based on plan design and philosophical differences, AAFES and Marine Corps systems share costs of their medical coverage equally (50/50) employees. The Navy Resale system assumes a greater share (78/22) of the cost.

Each system has a different combination of insured and self-insured programs based upon financial and employee perception considerations. For example, Navy Resale and Marine Corps have chosen to self insure the major coverage--medical. AAFES uses a hybrid of self insured and insured coverages.

A DoD commissioned Towers, Perrin, Forster, & Crosby (TPF&C) study of September 1989 found that typically, during each of the past two years, employer-sponsored indemnity medical plan costs have increased by 25 to 40 percent. In the extreme, some have increased as much as 90 to 100 percent in one year. The study believes this upward cost spiral to continue in the foreseeable future. NAF benefit programs have not been immune to spiraling health care costs suffered throughout the nation. In all three programs the major cost of health care is attributed to actual claims cost,

rather than insurance company administrative fees/premiums. The average combined medical costs for the three plans for the first half of 1990 have increased 23.5% over the same period in 1989.

The following table provides claims data for plan year 1989.

CLAIMS COST 1989

	AAFES	NAVY RESALE	MARINE CORPS
Claims Paid (Medical/Dental)	$40,976,844	$12,313,625	$4,198,439
Fees Paid	$2,350,634	$657,201	$214,953
Total Expense	$43,327,478	$12,970,826	$4,413,392
Percentage of Fees to Expense	5.73%	5.34%	5.12%
Stop Loss (CAP) Premium Paid	N/A	N/A	$161,652
Claims Paid by Stop Loss	N/A	N/A	$431,900
HMO Premiums Paid	$2,447,709	$2,322,193	$2,379,180

Claims processing procedures vary among the three systems. AAFES and Navy Resale rely on an insurance carrier for claims processing services, while the Marine Corps screens and validates claims prior to insurance company processing as well as validating claims processed by the carrier in accordance with the contract.

An attempt was made to calculate the impact and potential costs associated with a consolidated group insurance and medical/ dental program. Due to the multitude of variables a reasonable projection of savings could not be estimated. Consolidation of the three systems would not reduce the required payment of the major costs-medical claims (hospital, doctor and pharmacy, etc.).

A single office to administer the three welfare plans or a consolidated welfare plan would not be feasible short of consolidating the exchange systems because of the required interface with other organizational elements, i.e. payroll, personnel and financial systems would negate any potential cost savings.

Consolidated plan costs cannot be accurately determined until a decision has been made on the successor plan(s) to be offered under a consolidation. Real savings cannot be quantified without an actuarial study of those plan provisions.

The military exchange system is in direct competition with private sector retail organizations and their benefit programs. Benefit plan comparisons were made to private sector organizations and are contained in Appendix G, page G-10. As a matter of policy, benefit comparisons should be made with private sector retail organizations rather than to Civil Service. A military exchange must operate as a major retailer without comparisons to Civil Service benefits. Military exchanges are self-sustaining revenue generating operations without benefit of appropriated fund support.

A growing trend in the private sector is to offer flexible/ cafeteria benefit programs. AAFES has adopted one provision of flexible benefits under Section 125 of the Internal Revenue Code which allows employees to pay their group insurance premiums with pre-tax dollars. This results in savings to the employee for Federal, State and local income taxes. Both the employee and employer realize savings in FICA taxes on those payments.

The exchange elements should collectively conduct a study to determine whether flexible/ cafeteria benefit plan design is appropriate for the military exchange systems. The design of new employee benefits program will take minimum of two years to develop prior to implementation. Implementation would take a minimum of 1 year after completion of the study.

Consolidation notwithstanding, the three exchange systems benefits experts are planning to form a joint "users group" to meet and discuss current benefits issues, administration problems and industry trends. One of their initial projects should be to study flexible/cafeteria benefits programs.

A major consideration to any changes or modifications of existing NAF benefit programs is that they may be subject to collective bargaining under Title VII of the Civil Service Reform Act due to a recent Supreme Court decision. This may result in increased costs, plan modifications and delays in implementation.

RECOMMENDATIONS

12.1A. The study planned by AAFES, to determine whether a flexible/cafeteria benefits program is appropriate, should include Navy Resale and Marine Corps. A study undertaken jointly by the three exchange systems should proceed on or about 1 Jan 91, irrespective of consolidation of the systems.

12.1B. If consolidation results, the existing benefits plans will be used as the basis for designing a new plan.

12.2 RETIREMENT PROGRAMS

BACKGROUND

AAFES, Marine Corps, and Navy Resale have separate defined benefit (retirement) plans which are similar in many respects. However, there are a number of significant differences in the plans.

Navy Resale and Marine Corps systems offer voluntary participation to regular full time (RFT) and regular part time (RPT) nonappropriated fund (NAF) employees. The AAFES plan requires that RFT employees participate in the retirement plan as a condition of employment; RPT employees are not allowed to participate. The Navy Resale retirement program includes Navy Military Personnel Command (NMPC) and the U.S. Coast Guard employees while the Marine Corps program includes all other Marine Corps NAF employees (MWR, Billeting Fund, Child Development Centers, Aero Clubs, etc.). It is assumed that employees outside the exchange systems will not be part of a consolidated exchange program.

Each of the defined benefit plans have been reviewed and approved (qualified) by the Internal Revenue Service. Federal government plans, including the NAF plans, are exempt from many federal statutes regulating pension plans.

NAF employees are not covered under the Civil Service Retirement System (CSRS) nor the Federal Employee Retirement System (FERS). Most U.S. dollar paid NAF employees are covered by Social Security. Regulations prescribed under DOD 1401.1-M and applicable IRS regulations for qualified pension plans apply to NAF pension plans.

In addition to the basic defined benefit plan, AAFES offers a supplemental retirement savings plan (401k) with no employer contribution for all RFT employees and a supplemental deferred compensation (retirement) plan for executive personnel (funded solely by AAFES).

DISCUSSION

Benefit formulae for the three systems are similar and were patterned after the CSRS. The NAF plans are integrated with Social Security (SS offset). The three exchange systems intend to modify their plans to comply with the integration provisions of the Tax Reform Act of 1986 (TRA86). The CSRS is not subject to TRA86 and is not integrated with Social Security. When the changes to the benefit formulae of the respective retirement plans are made, they will no longer be comparable to the CSRS.

The effective date of this change has to be retroactive to 1 Jan 89 in accordance with TRA86. A common benefit formula for the period 1 Jan 89 through the date of consolidation would be desirable, should consolidation occur. The advantages of a common benefit formula would ease plan administration and communication of benefits to employees.

Plan design differences exist between all three systems as reflected at Appendix G, page G-15. Marine Corps offers disability in their retirement program. AAFES offers disability benefits through both retirement and welfare programs, while the Navy Resale offers disability benefits through the welfare program only.

All three basic retirement plans require employee contributions. Employee contributions to defined benefit plans, with a few exceptions, are made on an after-tax basis and have become increasingly rare in the private sector.

The level of employer funding is a result of an actuarial valuation of liabilities and the level of plan assets. Currently, Navy Resale and Marine Corps require no employer contributions. AAFES is making progressively smaller contributions each year and is expected to require no employer contribution within three years. AAFES and Navy Resale have irrevocable trusts with employees serving as trustees for plan assets. The Marine Corps uses a master trustee arrangement with a bank.

As stated, NAF employees are not covered under FERS. The most important reason for not adopting FERS, is that it would require an immediate and ongoing substantial employer contribution. Under FERS, the employer contributes to a defined benefit plan. The employer also provides matching contributions for the thrift plan of a minimum of 1% to a maximum of 5% of base pay. **Therefore, employers would always be required to contribute to the funding of the FERS retirement plan. Under no circumstance would there ever be a period when no employer contribution would be required as currently enjoyed by two of the three plans.**

AAFES and Marine Corps employees are fully vested after five years of credited contributory service whereas Navy Resale employees are fully vested after five years of employment service. This means that they have a right to the benefits they have earned under their respective plans.

AAFES has provided a supplemental deferred compensation plan benefit to members of its Executive Management Program since Dec 1969. The EMP has served a very useful purpose to fulfill the continuing requirement of AAFES for highly qualified and dedicated employees who are readily available to meet worldwide executive personnel requirements. The program has been a very effective recruitment and retention tool and should be used as a model for the other systems. The Senior Management Programs (SMP) of the Marine Corps and Navy Resale systems presently have no comparable plan for their executives. The estimated annual costs to provide the Supplemental Deferred Compensation Plan

benefit, currently offered by AAFES, to Marine Corps and Navy Resale employees would total $545k per year, assuming all UA-13's and above were included. This is based on current AAFES NORMAL costs of 5% of covered payroll (i.e., wages subject to retirement of EMP members) or approximately $2,500 annual per member. Supplemental life insurance and accidental deathcoverage are estimated to cost 0.21% of covered payroll. The AAFES EMP also provides for an annual physical for members over age 50 and a bi-annual physical for members under age 50. Current costs for these physicals is approximate $215 each.

Each plan has different investment philosophies and uses various investment managers and insurance companies to invest plan assets. Under total consolidation, economies of scale could be realized through a consolidation of the assets in terms of fee structures for investment managers. Further cost savings could be realized for professional services such as fund evaluation/consulting, fund custodian, actuarial and legal. The following table portrays the value of assets, fees charged and fee percentage for 1989 for each of the three systems.

PENSION PLAN INVESTMENTS 1989

	AAFES	MARCORPS	NAVY RESALE
Average Value of Assets	$1,422,410,511	$66,994,428	$636,614,982
Investment/ Management Fees Paid	$5,307,998	$88,509	$1,917,223
Fee Percentage	.37%	.60%	.35%

The fees Navy Resale is charged encompass three employers (NAVRESSO, NMPC, and Coast Guard). The market value of NAVRESSO assets is approximately 77.5% of the total market value of the Navy Resale and Services Support Office Pension Trust. Therefore, approximately 77.5% of the investment manager and administration fees are attributable to NAVRESSO with respect to its participation in the pension. The other two employers would not be part of the proposed consolidation.

The Marine Corps pension plan and trust includes exchange, Morale, Welfare and Recreation (MWR) and other NAF employees. Pension plan assets are commingled without separate accounting by functional area nor by individual participant. Separation of these assets will require an actuarial valuation for the respective functional groups. Obtaining a

consensus on the actuarial assumptions to be used will be particularly troublesome. Like Marine Corps, Navy Resale has a common plan and trust with the NMPC, and the Coast Guard. However, the retirement funds are accounted for separately for each organization. Under a total consolidation a transfer of funds to cover actuarially determined accrued liabilities between plans will be required; therefore, it is necessary that an exemption from the "no transfer of funds" provisions of DOD 1401.1-M, be requested.

Under partial consolidation, it is presumed that the provisions of H.R. 3139, the "Portability of Benefits for Department of Defense Nonappropriated Fund Employees Act of 1989" would apply. Respective retirement plan documents would have to be amended accordingly.

Some savings could be achieved in fees for legal, actuarial, consultant and accounting services. The requirement for legal services will continue for the Coast Guard and NMPC, as well as for Marine Corps MWR and miscellaneous Marine Corps NAFIs. In some instances the entire fees presently charged may very well carry over to these employers should they continue their present plan once separated from the larger plans and trusts.

Therefore, consolidation of the existing plans and trusts of the exchange systems could conceivably result in greater expenses and less income return to the Coast Guard, and NMPC, Marine Corps MWR and miscellaneous NAFIs successor plans and trusts. This may require larger contributions by them in order to maintain the integrity of their trust fund. This would mean less contribution to the MWR activities.

It would appear that a consolidation would result in the use of fewer managers thereby reducing the amount of fees. However, such a reduction may not occur. Fees paid to an investment manager are directly related to the size of the fund over which the manager exercises investment discretion. It is difficult to place a value on the savings that would be realized if all retirement funds were consolidated under a single trust. Intuitively, it can be deduced that there would be savings since the fees charged by most investment managers would be on a sliding scale. Any new funds added to an existing portfolio might be at lower fees.

The most important decisions trustees can make are asset allocations and the money managers chosen to implement such allocations. A determination as to which money managers are to be terminated will be required. The determination should not be made solely on the basis of a managers' fees without regard to their performance. Fee charges should not be the basis for terminating a manager.

There will be additional costs incurred for matters such as pension plan changes, merging records of all employees into one system, programming changes, possible hiring and firing of new money managers, etc. More importantly, a reduction in the number of money managers will require the sale of portfolios managed by the terminated money managers resulting in transaction costs and a possible loss on them if the securities are sold during unfavorable market conditions.

To date, each of the exchange systems' retirement plans are well funded and have been successful in controlling costs, negotiating fees and choosing successful investment managers. Their efforts have resulted in the excellent income return for the respective plans.

All three systems process retirement claims in-house and have an outside agency (insurance company or trustee) make annuity payments. No economies of scale could be realized through consolidation of these processes. Administrative fees to outside agencies for all systems are comparable. No reduced administrative fees for increased volume would be realized.

As stated in the welfare benefit discussion, the merger of the retirement administration function into a single office short of consolidation of the exchange systems would not be feasible. The required interface with other organizational elements within the respective systems, i.e. payroll, personnel, financial systems and data bases would negate any potential cost savings.

A restructured retirement plan would take at least five years to design, amend and implement.

A major consideration to any changes or modifications to existing NAF retirement programs is that they may be subject to collective bargaining under Title VII of the Civil Service Reform Act due to a recent Supreme Court decision. This may result in increased costs, plan modifications and delays in implementation.

RECOMMENDATIONS

12.2A. Under total consolidation the existing retirement plans will be used as a basis for the design of a new retirement plan.

12.2B Retirement plan assets covering actuarially accrued liabilities of the three systems will be combined into a single trust.

12.2C. In the event of consolidation, a supplemental deferred compensation benefit program modeled after the AAFES EMP should be developed and extended to all employees who qualify. Newly eligible employees accrue such benefits beginning no earlier than the date of consolidation.

SUMMARY OF RECOMMENDATIONS

AAFES already has a study planned to determine whether a flexible/ cafeteria benefits program is appropriate. This study should include Navy Resale and Marine Corps. This study should proceed, irrespective of consolidation of the systems. Under a total consolidation, a new employee welfare program will be designed and implemented.

Under a total consolidation, the existing plans will be used as the basis for the design of a new retirement plan. Retirement plan assets covering actuarially accrued liabilities will be combined into a single trust. In the event of consolidation, a supplemental deferred compensation benefit program modeled after the present benefit offered AAFES EMP members.

At best, under exchange

consolidation, a combined total of six employee benefits positions could be reduced at the Headquarters' level. Actual savings would depend upon positions eliminated and appropriate grade re-allocations. In the case of the Marine Corps, after consolidation of the exchange systems, the Morale, Welfare and Recreation (MWR) and miscellaneous NAFs not covered by consolidation would continue to require a benefits function. Consolidated plan costs cannot be accurately determined until a decision has been made on the successor plan(s) to be offered under a consolidation. Real savings cannot be quantified without an actuarial study of those plan provisions. Costs/costs avoidance attributable to the employee benefits programs cannot be expressed as an absolute value at this time.